

No. 12506 2630

United States
Court of Appeals

for the Ninth Circuit.

See vol. — 2631
WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I.
duP. BAYARD, Receiver,

Appellants,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO
NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY,
DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY
COMPANY, THE STANDARD REALTY AND DEVELOPMENT
COMPANY and DELTA FINANCE CO., LTD.,

Appellees.

MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE
& CO., INC.,

Appellants,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO
NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY,
DEEP CREEK RAILROAD COMPANY, THE WESTERN
REALTY COMPANY, THE STANDARD REALTY AND DE-
VELOPMENT COMPANY and DELTA FINANCE CO., LTD.,

Appellees.

Transcript of Record
In Five Volumes

Volume I
(Pages 1 to 444)

Appeals from the United States District Court,
Northern District of California,
Southern Division.

JUL 24 1950

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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In the District Court of the United States, for
the Northern District of California, Southern
Division

26508G

In the Matter of

THE WESTERN PACIFIC RAILROAD COM-
PANY, THE WESTERN PACIFIC RAIL-
ROAD CORPORATION,

Plaintiff,

vs.

THE WESTERN PACIFIC RAILROAD COM-
PANY, SACRAMENTO NORTHERN RAIL-
WAY, TIDEWATER SOUTHERN RAIL-
WAY, DEEP CREEK RAILROAD COM-
PANY, THE WESTERN REALTY COM-
PANY, THE STANDARD REALTY AND
DEVELOPMENT COMPANY and DELTA
FINANCE CO., LTD.,

Defendants.

BILL OF COMPLAINT FOR EQUITABLE
RELIEF

The Western Pacific Railroad Corporation, plain-
tiff herein, complaining of the above-named de-
fendants, respectfully shows:

I.

That the plaintiff is a domestic corporation created and existing under the laws of the State of Delaware.

II.

That each of the defendants is a domestic corporation created under the laws of the State of California except that The Western Realty Company and the Deep Creek Railroad Company are respectively domestic corporations of the States of Colorado and Utah.

III.

That this is a civil action in equity between citizens of different states; that the amount in controversy exceeds the sum of \$5,000; and to the extent that it relates to or may affect obligations and liabilities of the Trustees in the proceeding No. 26591-S assumed by the defendant, The Western Pacific Railroad Company, and to the res transferred to it by said Trustees it is an ancillary dependent suit within the jurisdiction reserved by this Court under its Order dated March 28, 1946.

IV.

That during the years 1942 and 1943 and the year 1944 or some part thereof the plaintiff and the defendants were an affiliated group of corporations within the meaning of Section 141 of the Internal Revenue Code and plaintiff on behalf of itself and of the defendants filed Income and Excess Profits Tax Returns on a consolidated basis

as the result of which there may be tax liabilities asserted or tax refunds recognized or inter-corporate adjustments required, the amount of which cannot be determined and equitably charged against or credited to one or more of the members of the affiliated group without an accounting and a judicial determination of their rights and liabilities inter sese and without the intervention of a Court of Equity. That for the year 1942 a Return was filed showing tax liabilities for the affiliated group which were paid by the then Trustees of the Estate of The Western Pacific Railroad Company out of funds in their custody derived from trusteeship operations that for the year 1943 and part of the year 1944 Consolidated Income Tax Returns were filed by the plaintiff for itself and its affiliates which reported a deductible loss by the plaintiff in an amount sufficient to eliminate all taxable income for the group as a whole for 1943 and to provide unused credit balances to carry back to 1942 and carry forward to 1944 sufficient to eliminate taxable income for the affiliated group for the period to which such Returns relate, and that in 1945 the plaintiff for itself and its affiliates as their rights may appear filed with the Collector of Customs in the City and State of New York a claim for a refund of the taxes paid by the Trustees of the estate of The Western Pacific Railroad Company for 1942—said claim being in the amount of \$4,201,821.54.

V.

That there is no statutory rule or regulation for the apportionment of tax liabilities or tax benefits among members of an affiliated group of corporations within the scope of said Section 141 of the Internal Revenue Code and their rights and liabilities inter sese growing out of what is done by one member on behalf of all rest upon the established principles of equity and are only cognizable in a Court of Equity which through its flexible action of accounting may render its decree in favor of any one or more of the parties and against any one or more of the other parties and may apportion among the parties any fund or funds in respect of which one or more parties may interplead.

VI.

That by the terms of the Revenue Code and the Regulations of the Treasury thereunder the fund of \$4,201,821.54 in respect of which the plaintiff has filed a refund claim on behalf of itself and the other members of the affiliated group as their interests may appear is payable to the plaintiff and the plaintiff itself claims to be the beneficial owner of the claim but to the end that the ownership of the fund and any rights of other members of the group thereagainst may be judicially determined the plaintiff hereby brings said fund together with any deductions therefrom or accretions thereto into the Court and interpleads against the other members of the group in respect thereof in order that the right of

all members of the affiliated group therein may be fixed and determined.

VII.

That by reason of the Returns filed by the plaintiff on behalf of itself and other members of the affiliated group and the deductible losses shown thereby or reflected therein certain tax benefits have accrued in respect of which reserves have been set up by one or more members of the affiliated group in amounts aggregating approximately \$10,100,000 which belong to the members of the affiliated group as their rights may appear, and the plaintiff itself claims to be the beneficial owner of said reserves but to the end that the ownership of the said reserves and any rights of members of the group thereagainst may be judicially determined the plaintiff brings this proceeding to place said reserve fund in judicial custody or subject to the jurisdiction and supervisory power of this Court in order that the rights of all members of the affiliated group therein may be fixed and determined.

For as much, therefore, and the plaintiff and the defendants are remediless at law for the determination of their rights inter sese and the respective interest of each thereof, if any, in the several funds referred to in this Bill of Complaint and can obtain appropriate relief in a Court of Equity where matters of account as well as matters of equitable adjustment are peculiarly cognizable, the plaintiff files this Bill of Complaint and prays equitable relief as follows:

1. That this Court place in judicial custody all moneys in or coming into the hands of the parties to this proceeding representing refund claims or reserves in respect of taxes paid or withheld from payment under or in respect of Federal Income taxes and Excess Profits taxes, either or both for the years 1942, 1943 and 1944 or any part thereof.

2. That the respective rights and interests of the plaintiff and the defendants and each thereof in and to said funds be fixed and determined or in lieu thereof or in addition thereto that the beneficial interest of the plaintiff and the defendants in any tax saving resulting from the contribution of income by one or more members of the affiliated group to which they belong and the contribution of offsetting deductible losses by one or more other members of the same group be fixed and determined by this Court in accordance with the principles of equity and good conscience.

3. That an account be stated in accordance with respective rights and interests of the plaintiff and the defendants in and to said funds and tax savings showing the amounts due each in respect thereof.

4. That a decree be rendered conforming to such stated account and directing that the plaintiff and the defendants recover the amounts shown to be due them thereunder.

5. That the parties hereto be enjoined and restrained from disbursing any funds in or coming into their custody or possession and constituting

the refunds and reserves referred to in this Bill of Complaint except upon the Order of this Court.

6. That the plaintiff have such other and further relief by way of declaratory decree or judgment or otherwise as it may be advised and to the Court shall seem meet.

Dated: Oct. 10, 1946.

THE WESTERN PACIFIC
RAILROAD CORPORATION,

By /s/ LeROY R. GOODRICH,
Its Attorney.

/s/ FRANK C. NICODEMUS, JR.,

/s/ A. PERRY OSBORNE,
Of Counsel.

[Endorsed]: Filed Oct. 10, 1946.

[Title of District Court and Cause.]

ANSWER AND COUNTERCLAIM OF DEFENDANTS THE WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY COMPANY, DELTA FINANCE CO., LTD., AND STANDARD REALTY AND DEVELOPMENT COMPANY

Come now defendants The Western Pacific Railroad Company, Sacramento Northern Railway,

Tidewater Southern Railway Company (sued herein as Tidewater Southern Railway), Delta Finance Co., Ltd., and Standard Realty and Development Company, and answering the complaint of plaintiff herein and by way of counter claim, admit, deny and allege as follows:

I.

Admit paragraphs I and II of the complaint, except the allegation that Deep Creek Railroad Company is a domestic corporation, and allege in that respect that Deep Creek Railroad Company was formerly a Utah corporation, and that all of its stock was owned at all times herein mentioned by defendant The Western Pacific Railroad Company, and that said Deep Creek Railroad Company was in process of liquidation in the years 1942, 1943 and 1944 and was finally dissolved in the year 1944.

II.

Answering paragraph III of the complaint, admit that this is a civil action between citizens of different states and that the amount in controversy exceeds the sum of \$5,000 exclusive of interest and costs; deny all the averments contained in paragraph III of the complaint except those hereinbefore expressly admitted.

III.

Answering paragraph IV of the complaint, admit, deny and allege as follows: During the years 1942 and 1943 and the first four calendar months of the year 1944, the plaintiff and the defendants, including

the defendant Deep Creek Railroad Company, which was in the process of liquidation in the years 1943 and 1944, were an affiliated group of corporations within the meaning of the Internal Revenue Code. Plaintiff was at all said times the parent corporation of said group and filed income and excess profits tax returns on a consolidated basis for said group for the said years 1942 and 1943. In the year 1945 plaintiff filed an income and excess profits tax return for the year 1944 and included in said return the income of the other members of said affiliated group for the first four months of 1944. The said consolidated return for the year 1942 reported income and excess profits tax payable by the affiliated group in the sum of \$4,201,821.54, and the aforesaid returns for the years 1943 and 1944 reported no taxable income. On March 9, 1945, the plaintiff filed with the Federal Collector of Internal Revenue in the Second District of New York a claim for refund of the sum of \$4,201,821.54 theretofore paid as income and excess profits taxes for 1942, together with the interest thereon. The whole of said last mentioned amount of tax was paid in 1943 by plaintiff with funds supplied to plaintiff for that purpose by the Reorganization Trustees of defendant The Western Pacific Railroad Company. Thereafter and in the year 1943 certain of the defendants herein paid or credited to said Reorganization Trustees their respective portions of said tax, so that the net amounts of said tax borne and paid by the parties to this suit were as follows:

Plaintiff	\$	00.00
Defendant The Western Pacific Railroad Company.....		4,144,828.87
Defendant Sacramento Northern Railway.....		2,847.58
Defendant Tidewater Southern Railway Company.....		53,608.94
Defendant The Western Realty Company.....		00.00
Defendant Deep Creek Railroad Co.....		00.00
Defendant Standard Realty and Develoment Company.....		00.00
Defendant Delta Finance Co., Ltd.....		536.15
		<hr/>
Total	\$	4,201,821.54

The defendant The Western Pacific Railroad Company is entitled to the whole of said sum when refund thereof is made, together with all interest thereon, and to the whole amount refunded, and will upon receipt of said refund credit or pay to the defendants Sacramento Northern Railway, Tidewater Southern Railway Company, and Delta Finance Co., Ltd., their respective proportions thereof, and said three last named defendants will look to defendant The Western Pacific Railroad Company for such credit or payment. None of the parties to the above-entitled cause, other than the defendant The Western Pacific Railroad Company and said last named three defendants, paid or contributed

any sum or thing of value to the payment of said tax or any part thereof, and none of said parties other than the defendant The Western Pacific Railroad Company has any right, title, interest or claim, at law or in equity, in or to said refund claim or the amount refundable thereunder or any part thereof. Under and by virtue of the Internal Revenue Code and the regulations thereunder providing for and relating to consolidated returns for affiliated corporations, the tax liability of said affiliated group for Federal income and excess profits taxes was required to be, and was, determined upon the basis of the taxable net income of the said group as a unit. Provision for the allocation to the respective members of such group of their proportion of the tax so determined to be payable was lawful and proper, and the whole of said tax for 1942 was allocated to the defendant The Western Pacific Railroad Company and the three other defendants aforesaid, as above set forth, but no right, title, interest or claim was created or arose, or could be created or arise, on the part of any member of said affiliated group against any other member thereof, by virtue of said consolidated returns or any thereof, or by virtue of the individual deductible losses or taxable gains of such members, or otherwise, for any sum in excess of the portion of the tax actually paid or payable by the member making such claim. In the year 1943 plaintiff and other members of said group incurred deductible losses in the total amount sufficient to eliminate all taxable income for the affli-

ated group for 1943 and to provide unused credit balances to carry back to 1942 and carry forward to 1944 sufficient to establish no taxable income for the years 1942 and 1944, and in said federal tax returns for 1943 and 1944 plaintiff reported said losses and said carry-back and carry-forward portions thereof, and the aforesaid claim for refund of the 1942 taxes referred to the said carry-back. The major portion of the aforesaid deductible losses incurred in the year 1943 was the loss of plaintiff arising from the fact that the stock of the defendant The Western Pacific Railroad Company held by plaintiff became worthless in said year. In and by reporting said loss in said returns for 1943 and 1944, and in and by referring to same in filing said claim for refund, plaintiff suffered no detriment, loss, cost or expense and furnished no legal or equitable consideration or contribution to the members of the affiliated group or to any of them. These answering defendants deny all the averments contained in paragraph IV of the complaint except those hereinabove expressly admitted.

IV.

Deny the averments contained in paragraph V of the complaint.

V.

Answering paragraph VI of the complaint, admit, deny and allege as follows: By the terms of the Internal Revenue Code and the regulations thereunder, the amount refundable under said refund claim is payable by the United States to the plaintiff

as collecting agent for the member of said group, namely, defendant The Western Pacific Railroad Company, which originally provided the moneys for payment of the tax. Said claim was filed and is made for the use and benefit of said defendant as the member of said affiliated group which provided the moneys for payment of the entire tax for the group. The other defendants which contributed to the payment of said tax, namely, Sacramento Northern Railway, Tidewater Southern Railway Company, and Delta Finance Co., Ltd., will look to defendant The Western Pacific Railroad Company for credit or payment of their proportions of said refund. Plaintiff is not entitled beneficially to the refund of the same or any part thereof or any interest thereon. Neither said claim for refund nor the moneys that are refundable thereunder constitute or are a fund of said affiliated group, or a fund in respect whereof the members of said group may interplead or be interpleaded, but on the contrary said claim is the exclusive right and property of defendant The Western Pacific Railroad Company and said defendant is entitled to the whole sum refundable thereunder.

VI.

Answering paragraph VII of the complaint, admit, deny and allege as follows: Defendant The Western Pacific Railroad Company has a reserve fund for contingent tax liabilities in the sum \$10,-100,000, invested in United States Government Securities, for the purpose of discharging the liability

of said defendant for such federal income and excess profits taxes, if any, as may be imposed upon said defendant for the years 1943 and 1944. Neither the plaintiff nor any member of said affiliated group other than the defendant The Western Pacific Railroad Company furnished or contributed any money or other thing of value to said fund. Said fund and the securities comprising the same are the exclusive property of the defendant The Western Pacific Railroad Company and the said fund is held by said defendant to provide for the payment of its own taxes, if any are payable by it, and not for the benefit, advantage, use or behoof of plaintiff or any other member of said group. Neither said fund nor any part thereof is a fund of said affiliated group, or a fund in respect whereof the members of said group may interplead or be interpleaded, and neither plaintiff nor any member of said affiliated group other than the defendant The Western Pacific Railroad Company has any right, title, interest or claim in or to said fund, or in or to any part thereof, at law or in equity. Deny all the averments contained in paragraph VII of the complaint except those hereinbefore expressly admitted.

VII.

It was plaintiff's duty under the Internal Revenue Code and regulations to make and file income and excess profits tax returns for the years 1942, 1943 and 1944. In and by making and filing said income and excess profits tax returns for the years 1942, and 1943 and 1944 plaintiff performed its said duty

in accordance with the requirements of the Code and regulations. Plaintiff as a separate corporation had no income or excess profits tax liability on either a separate or consolidated basis for 1942, 1943 and 1944 and paid no tax for any of said years. In and by filing said returns plaintiff furnished no consideration or contribution whatsoever to other members of said affiliated group, or any of them, and suffered no detriment, loss, cost or expense for itself or for said members or any of them, in that its action in filing said returns was performed under a duty imposed by law.

VIII.

In and by filing the said returns for the years 1942, 1943 and 1944, and in and by filing said refund claims, plaintiff acted as the agent and representative of the affiliated group to file such returns and claim for refund, but plaintiff did not therein or thereby gain or acquire any right or claim as against any other member of said group to be paid any sum or sums or receive anything of value for or on account of filing said returns or claim, or for or on account of theoretical taxes not paid or payable by said group or any member thereof, and on the contrary the exaction or receipt by plaintiff from the members of said group or any thereof, of any sum or other thing of value, for or on account of so-called tax savings, to wit, moneys not paid or payable as taxes, by any other member or members of said group, resulting from the filing of consolidated returns, would have been and was and is

inequitable, unjust, and unconscionable, and the claims made by plaintiff in this cause to payment or other compensation for or on account of such tax savings, were and are inequitable, unjust, and unconscionable, in that the plaintiff was an agent and fiduciary for the members of said affiliated group in making said returns, and may not lawfully or equitably use or avail of its said agency to obtain or secure a profit or advantage for itself at the expense of other members of said group for whom it was such agent.

IX.

In and by filing the said returns and filing said refund claim, plaintiff acted as the agent and representative designated by the Internal Revenue Code and the regulations thereunder relating to consolidated returns for affiliated groups, but plaintiff did not therein or thereby gain or acquire any right or claim as against any other member or members of said group to be paid any sum or sums or receive anything of value for or on account of filing said returns or claim, or for or on account of taxes not paid or payable by said group or any member thereof, and on the contrary the exaction or receipt by plaintiff from the members of said group or any thereof, of any sum or other thing of value, for or on account of such filing or said taxes not paid or payable, would have been and was and is illegal, unjust and inequitable, and contrary to the intent and purposes of the Internal Revenue Code and the regulations thereunder, and plaintiff's claims in this

cause are illegal, unjust and inequitable, and contrary to the intent and purposes of the Code and said regulations, in that such exaction or receipt and the claims made by plaintiff in this cause would constitute and be a purchase and sale of deductible tax losses, or exaction of compensation therefor, and a sale of the privilege of filing consolidated returns, contrary to the intent and purpose of the said statutes, and the regulations thereunder.

X.

At the time plaintiff filed said consolidated returns for the year 1943, to wit, July 15, 1944, wherein plaintiff reported its said large deductible loss of 1943, plaintiff had an interest in the said affiliated group, in that plaintiff was then entitled, under certain contingencies, to regain the ownership of all the stock of the defendant, The Western Pacific Railroad Company, and plaintiff's act and decision in filing the same was done and taken for the advantage and benefit of plaintiff in that plaintiff's said contingent interest in the stock of said defendant gave to plaintiff an interest in the effect upon the tax liability of said defendant of filing said consolidated returns. In and by reporting said deductible loss in said consolidated return, plaintiff elected to, and became bound to, apply the carry-back portion thereof to the year 1942, and to file a refund claim on account of such carry-back and the aforesaid refund claim was thereafter filed by plaintiff in pursuance of its said election and obligation so to do.

XI.

Ever since the year 1918 and until April 30, 1944, plaintiff was the parent corporation of and controlled the members of an affiliated group of corporations and determined whether or not consolidated returns should be filed for said group, including itself, and therein and thereby exercised for itself and said group and in the common interests of the members of the group and the interest of the plaintiff as the sole owner of the ultimate equity in the group the statutory privilege extended by the applicable provisions of The Revenue Acts and Section 141 of the Internal Revenue Code of filing or not filing consolidated returns and elected continuously in favor of consolidated returns and therein and thereby plaintiff elected for itself and the other members of said group and from time to time committed the group for future years to file such consolidated returns. The defendants The Western Pacific Railroad Company and Deep Creek Railroad Company were members of said affiliated group at all of said times and the other defendants herein were members of said group at various times. In and by its said control and elections from time to time plaintiff derived many advantages and benefits in the manner and to the extent intended by the said statutes and regulations, including, among others, the future consequences of such elections, as well as the results and effects in the years of filing the returns, and the various members of said group, including plaintiff, had variously individual incomes and deductible losses

taken up in said consolidated returns from year to year. At all said times plaintiff controlled the allocation of the taxes as between the members of said group, and continuously and consistently allocated the group tax for each year between the members of said group, including itself, who had individual taxable incomes in such year, in the proportions that their individual incomes bore to the total of such incomes, ignoring losses of other members of the group, but plaintiff never charged itself nor claimed credit for itself or charged or claimed credit for any member of said group for or on account of theoretical taxes not payable by the group in consequence of deductible losses suffered or incurred by one or more of its members in years when other members had taxable gains. Plaintiff never made any claim of that nature against or in favor of any member of the group until the making of the claims stated in its complaint herein, which said claims were not made until long after the said affiliation had been severed and were made at a time when plaintiff had no ownership of or interest in said group or any member thereof. Plaintiff and all other members of said group became bound by, and agreed to, the said long continued custom and practice of allocating between the members of said group the actual group tax, and no more, and therein and thereby plaintiff waived and relinquished whatsoever right it might otherwise have had to claim as against any member of said group, any other or further allocation, adjustment or claim arising out of the filing of such consolidated returns

or the individual taxable gains and deductible losses of the members of said group. By reason of said custom, practice and agreement and by reason of the advantages and benefits received by plaintiff from the said exercise of its privilege of filing consolidated returns for said group for all said years, plaintiff's claims in this suit are unjust, inequitable and unconscionable.

XII.

At all times mentioned herein to and including April 30, 1944, plaintiff was the owner and holder of all of the capital stock of defendant The Western Pacific Railroad Company. From August 2, 1935, to December 29, 1944, defendant The Western Pacific Railroad Company was a railroad corporation in reorganization under the provisions of Section 77 of the Bankruptcy Act, in that certain proceeding in the United States District Court for the Northern District of California, Southern Division, entitled "In the Matter of The Western Pacific Railroad Company," No. 26591 S in the files of said Court, and the title to and possession of all of its properties were at all times from September 23, 1935, to December 29, 1944, held by T. M. Schumacher and Sidney M. Ehrman, as the Reorganization Trustees appointed by said court. Said defendant The Western Pacific Railroad Company was reorganized in said proceeding under a Plan of Reorganization filed by the Interstate Commerce Commission June 21, 1939, which said Plan of Reorganization was finally confirmed by said Court by

its order in said proceeding made October 11, 1943. In and by said Plan of Reorganization as finally confirmed October 11, 1943, it was determined that the stock of said defendant held by plaintiff herein, being all of the preferred and common capital stock of said defendant, was without equity or value. Under and pursuant to said Plan of Reorganization and the order of said Court in said proceeding made November 27, 1944, and at 12:01 a.m., on December 29, 1944, said Trustees returned and transferred to the said reorganized corporation, defendant The Western Pacific Railroad Company, all the business, assets and property, of every kind and description held by said Trustees in said bankruptcy proceeding, free and clear of all claims other than such claims as were preserved under the said Plan of Reorganization and were not limited or discharged by the orders of said Court. A copy of said Order of November 27, 1944, is hereunto annexed, marked Exhibit 1.

XIII.

In and by its claims against the defendant The Western Pacific Railroad Company and against and in respect of the said reserve and the said refund claim belonging to the defendant The Western Pacific Railroad Company, plaintiff seeks to establish and enforce liens senior to the liens of those claimants in said reorganization proceeding whose liens were found to have equity and value and were preserved and provided for in the said Plan of Reorganization, and plaintiff seeks thereby to gain

a preference over such claimants. The entire business, assets and properties of said reorganized company were returned and transferred to it by said Trustees pursuant to said Plan and the orders of said Court, subject only to the claims so preserved. In and by said Plan of Reorganization all claims junior to the claims of First Mortgage Bondholders and General and Refunding Mortgage Bondholders of said defendant The Western Pacific Railroad Company were found and determined to be without equity or value, and the claims of said bondholders were preserved, and were paid and discharged under said Plan in common stock, and other securities, of the said reorganized company, so that the said bondholders became the owners of the entire common stock of the reorganized company. Plaintiff's aforesaid claims in this cause and each of them are unjust, inequitable and unconscionable in this, that the aforesaid deductible loss incurred by plaintiff, and the filing of said federal tax returns and refund claim reporting said loss, furnish no just or equitable ground or reason for giving or granting to plaintiff a preference over said prior claimants, to wit, said bondholders, as to all or any part of said reserve fund or said refund claim or any other assets or property of said reorganized company, but said claims of plaintiff cannot now be recognized or allowed in any manner or to any extent without thereby granting such inequitable preference.

XIV.

Each and all the claims of plaintiff in and to said reserve fund, or any portion thereof, and in and to said refund claim, or the amount refundable thereunder, are unjust, inequitable, and unconscionable in all the respects hereinafter in this paragraph XIV averred or mentioned. Said claims and each of them arose and could have been presented to the said Bankruptcy Court more than two years before the commencement of this action. Plaintiff was a party to said reorganization proceeding and had personal notice of all of the proceedings in the Bankruptcy Court and before the Interstate Commerce Commission in respect of the business, assets and properties of the defendant The Western Pacific Railroad Company and the Plan of Reorganization thereof, and stood by and wholly failed and neglected to present said claims, or any thereof, to the said Court or to said Commission or to the said Reorganization Trustees or to the defendant The Western Pacific Railroad Company, and wholly failed to notify the said Court, Commission, Trustees or defendant company thereof prior to the effectuation and consummation of said Plan of Reorganization, and permitted the said Plan to be effectuated and consummated without presenting or giving notice of said claims to said Court, Commission, Trustees or defendant company so that said Plan of Reorganization was effectuated and consummated by said Trustees pursuant to said Plan and the orders of said Court and Commission, and all parties in interest under said Plan accepted

and received the new securities and the other provisions made for them under said Plan, without notice of plaintiff's said claims, or any thereof. Plaintiff further stood by and wholly failed and neglected to present its said claims, or any thereof, to the said Court, Trustees and defendant company, or any thereof, and wholly failed to notify them or any of them of such claims or any thereof, prior to the final settlement of the accounts of said Trustees by said Court, and prior to the termination of said reorganization proceedings, and permitted said accounts to be settled and said proceedings to be terminated without giving notice of said claims or any thereof, or presenting the same or any thereof, and all parties in interest participated in the said proceedings, and said accounts were settled and allowed, and said proceedings were terminated, without any party to said proceedings having notice of said claims or any thereof. In and by the neglect and conduct of plaintiff aforesaid plaintiff was guilty of laches and the said claims and each and all thereof became and are stale and inequitable, and barred by the said laches and inequitable conduct and neglect of plaintiff. These defendants refer to the averments of paragraphs I to XIII of this answer in connection with and as stating further grounds for their defense that plaintiff's claims are stale and barred by plaintiff's laches.

XV.

The rights of action set forth in the complaint in respect of, or pertaining to, that portion of the

reserve fund created by said court order, to wit, \$7,100,000 did not accrue within two years next before the commencement of this action. The rights of action set forth in the complaint in respect of the remainder of said reserve fund, to wit, \$3,000,000 and in respect of the said refund claim, to wit, the claim for refund of \$4,201,821.54 taxes paid for the year 1942, did not accrue within two years next before the commencement of this action.

XVI.

Said Bankruptcy Court on March 28, 1946, made its Final Order in said reorganization proceeding terminating said proceeding, subject only to the reservations of jurisdiction made and referred to in said order, and in and by said order said Court permanently restrained and enjoined all persons from instituting, prosecuting or pursuing claims against said defendant The Western Pacific Railroad Company, or against any of the assets or property of said defendant, on account of any right, claim or interest which such person might have had in, to or against said defendant, or any of its assets or properties, on or before December 28, 1944 (except as specifically provided for or permitted by prior order of said Court). A copy of said Final Order is hereunto annexed, marked Exhibit 2. In and by said Final Order plaintiff was and is forever restrained and enjoined from instituting or prosecuting this cause as against the defendant The Western Pacific Railroad Company and from instituting or prosecuting any action or

proceeding to establish or enforce the claims and each thereof against said defendant which are set forth in its complaint herein.

XVII.

In and by said Plan of Reorganization and the said Orders of said Court, Exhibits 1 and 2 to this answer, and each of them, plaintiff was and is forever barred and foreclosed from claiming as against the defendant The Western Pacific Railroad Company all or any part of the aforesaid claim for refund of taxes paid by said Trustees in the sum of \$4,201,821.54, and forever barred and foreclosed from claiming all or any part of the said refund, when made; and the whole sum payable upon said refund claim, including interest thereon, became and was and is the property and asset of defendant The Western Pacific Railroad Company, free and clear of all claims and demands of plaintiff.

XVIII.

In and by said Plan of Reorganization and the said Orders of said Court, Exhibits 1 and 2 to this answer, and each of them, plaintiff and all parties to this action other than defendant The Western Pacific Railroad Company were and are forever barred and foreclosed from claiming all or any part of said reserve fund of \$10,100,000 and forever barred and foreclosed from claiming against said defendant any sum or contribution whatsoever, on account of the so-called tax savings, to wit, the non-existence of taxable net income, reported by the

said returns filed for the years 1943 and 1944, and the entire business, assets and property returned and transferred by said Reorganization Trustees to said defendant were in and by said Plan and Orders returned and transferred to said defendant free and clear of all such claims of plaintiff and the other members of said affiliated group or any of them. In and by said Orders of said Court and the said Plan of Reorganization and each of them, each and every, all and singular, the claims of plaintiff in this cause against the defendant The Western Pacific Railroad Company were and are forever barred and foreclosed.

XIX.

Said Bankruptcy Court on March 3, 1944, made its order authorizing and directing the said Trustees to establish a reserve fund for contingent tax liabilities in the amount of \$7,100,000, for the sole and exclusive purpose of providing for the payment of federal income and excess profits taxes for the year 1943 in the event the same should become payable by said Trustees or by the reorganized company, defendant The Western Pacific Railroad Company. A copy of said Order is hereto annexed marked Exhibit 3. In and by said Order, said reserve fund became and was, and is, a fund belonging exclusively to the reorganized company, defendant The Western Pacific Railroad Company, and may not be subjected to the claims of the other members of the said affiliated group or any of them. Said

reserve fund created by said Court order is a part of the reserve fund of \$10,100,000 mentioned in plaintiff's complaint. The remainder of said reserve fund, to wit, \$3,000,000, was created by resolution of the Board of Directors of the reorganized company The Western Pacific Railroad Company adopted March 26, 1945, for increasing said reserve fund held for said purposes, exclusively, to the sum of \$10,100,000. Neither plaintiff, nor any other member of the affiliated group, other than defendant, The Western Pacific Railroad Company, has ever contributed anything to said reserve fund and neither plaintiff nor any of the said other members of said group have any right, title, interest or claim in or to said reserve fund, or in or to any portion thereof at law or in equity.

XX.

Plaintiff's complaint fails to state a claim upon which relief can be granted to plaintiff against defendants or any of them.

Counterclaim

For a counterclaim of the answering defendants herein, said defendants aver as follows:

I.

Defendants refer to and by such reference incorporate in this counterclaim all and singular the averments, admissions and denials in their foregoing answer.

II.

Defendant, The Western Pacific Railroad Company, is the owner of said fund and said refund claim and is entitled to the moneys refundable under said claim, and plaintiff has no right, title, or interest, at law or in equity, in or to said fund or the said refund claim or the taxes refundable thereunder.

III.

A controversy exists between plaintiff on the one part, and these defendants on the other part, regarding the rights of the parties arising out of, or in respect to, the said reserve fund and refund claim, and regarding the rights and obligations of the plaintiff and the defendants as members of the aforesaid affiliated group to pay or contribute or receive inter sese any sum or sums of money or other thing of value on account of federal income and excess profits taxes not paid or payable by said parties for the years 1942 and 1943 and 1944, or any portion thereof. Plaintiff contends that certain sums are payable by members of said group and are receivable by other members of said group on account of such taxes not paid or payable, in consequence of the fact that losses of some members and gains of other members were included in determining that there was no such tax liability for said years, and these defendants contend on the contrary that no rights or obligations to receive or pay any sum or sums arose or were created as between the members of said group by reason of such

taxes not being paid or payable, either in consequence of such gains or losses of members of the group, or otherwise.

IV.

All the parties necessary to the determination of said controversy are parties to the above-entitled cause.

V.

Plaintiff threatens to, and will, unless restrained and enjoined by this Honorable Court, collect and receive for itself, and apply to its own use and benefit, the sums to be refunded under said refund claim, to the great and irreparable loss of the defendant, The Western Pacific Railroad Company.

Wherefore, defendants pray for the order, judgment, and decree of this Honorable Court:

1. Forever restraining and enjoining plaintiff from receiving for itself, or applying to its own use or benefit, all or any part of the moneys refundable under said claim for refund.

2. Ordering and directing plaintiff by the mandatory order and injunction of this Court to endorse and deliver to the defendant, The Western Pacific Railroad Company, each and all checks, drafts or other commercial or Treasury paper received by plaintiff representing said refund or any part thereof.

3. Declaring and determining that defendant, The Western Pacific Railroad Company, is the sole

owner of and is exclusively entitled to said reserve fund and said refund claim and all sums refundable thereunder, and quieting the right and title of said defendant therein and thereto against the claims of plaintiff and all other parties to this cause, and restraining and enjoining plaintiff and all other parties to this suit other than defendant, The Western Pacific Railroad Company, from instituting or prosecuting claims thereto.

4. Declaring and determining that plaintiff has no rights or claims against these answering defendants or any of them for on or account of any matter or thing averred in plaintiff's complaint herein.

5. For defendants' costs of suit herein, and all such other and further relief as may be meet and equitable in the premises.

Dated: December 3, 1946.

THE WESTERN PACIFIC RAILROAD CO.,
SACRAMENTO NORTHERN RAILWAY,
TIDEWATER SOUTHERN RAILWAY CO.,
DELTA FINANCE CO., LTD.,
STANDARD REALTY AND DEVELOPMENT
CO.,

By /s/ ALLAN P. MATTHEW,
JAMES D. ADAMS,
ROBERT L. LIPMAN,
BURNHAM ENERSEN,
Their Attorneys.

Receipts of copy acknowledged.

EXHIBIT 1

Original Filed Nov. 27, 1944, with Clerk, U. S.
Dist. Court, San Francisco.

Pillsbury, Madison & Sutro,
Standard Oil Building,
San Francisco, California.

Whitman, Ransom, Coulson & Goetz,
40 Wall Street,
New York 5, N. Y.

In the District Court of the United States for the
Northern District of California, Southern Division

No. 26591-S

In the Matter of:

THE WESTERN PACIFIC RAILROAD COMPANY,

Debtor.

ORDER DIRECTING THE REVESTING OF
PROPERTIES OF THE DEBTOR IN THE
DEBTOR COMPANY, FIXING THE DATE
FOR CONSUMMATION OF THE PLAN
AND AUTHORIZING AND DIRECTING
THE CARRYING OUT OF THE PLAN

The petition filed November 8, 1944, by Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, the Reorganization Committee designated to put into effect and carry out the plan of reorganization

of the debtor above named, for an order directing the revesting of properties of the debtor in the debtor company, fixing the date for consummation of the plan, approving forms of deeds and agreements and authorizing and directing the carrying out of the plan of reorganization, came on duly to be heard on November 27, 1944, and was heard and has been submitted.

The Court being fully advised in the premises, finds that notice of the hearing upon said petition has been given as prescribed by the order of this Court dated and filed November 8, 1944, and that all of the allegations and representations contained in the petition are true. The Court further finds and concludes:

(a) Pursuant to the order of this Court entered September 25, 1944, approving the proposed Certificate of Amendment to the Articles of Incorporation and proposed amended By-Laws for the debtor company, the stockholders and Board of Directors of The Western Pacific Railroad Company have approved and adopted said Certificate of Amendment and said amended By-Laws and have authorized the necessary filing of said Certificate of Amendment; and upon such filing of said Certificate of Amendment, The Western Pacific Railroad Company will be a proper corporate instrumentality for putting into effect and carrying out the plan of reorganization;

(b) The stockholders of The Western Pacific Railroad Company have consented in writing to the execution and delivery of the Indenture relat-

ing to the First Mortgage Bonds and the creation by The Western Pacific Railroad Company of the bonded indebtedness as provided therein, and have consented in writing to the execution and delivery of the Indenture relating to the General Mortgage Income Bonds and the creation by The Western Pacific Railroad Company of the bonded indebtedness as provided therein and have authorized the assumption by said Railroad Company of certain obligations of the debtor company and its estate as contemplated by the plan of reorganization and have authorized the Board of Directors to issue shares of preferred and common stock, subject to the provisions of said Articles of Incorporation as so amended, and have authorized and directed the Board of Directors to do all other acts and things that may be necessary or appropriate in carrying out and making effective said plan of reorganization;

(c) The Board of Directors of The Western Pacific Railroad Company has approved the form of Indenture relating to the First Mortgage Bonds contemplated by the plan, the form of Indenture relating to the General Mortgage Income Bonds contemplated by the plan, the form of Scrip Agreement relating to the issuance of scrip in respect of fractional General Mortgage 4½% Income Bonds, Series A, shares of Preferred Stock, Series A, and shares of common stock; has approved the bond, scrip and other forms included in said Indentures and Scrip Agreement, and the forms of

certificates for shares of Preferred Stock, Series A, and shares of common stock, and determined the manner of executing the same; has approved mortgaging and pledging the properties and franchises of said Railroad Company, as contemplated in the Indentures mentioned above; has authorized and directed the execution and acknowledgment, and delivery, on or before the date fixed by the Court for the consummation of the plan of reorganization, of said Indentures and the necessary filing and recording thereof, the issue on said date of \$10,000,000 aggregate principal amount of First Mortgage 4% Bonds, Series A, \$21,219,000 aggregate principal amount of General Mortgage 4½% Income Bonds, Series A, 318,502 shares of the authorized Preferred Stock, Series A, not more than 319,032.767 shares of the common stock and the required scrip certificates, and the assumption of obligations by said Railroad Company, all as contemplated by said plan of reorganization and authorized and directed by the orders of the Court herein;

(d) The proposed deed from the debtor's Trustees to The Western Pacific Railroad Company; the proposed deed of release and satisfaction of mortgage from Crocker First National Bank of San Francisco and Samuel Armstrong, as Trustees under the debtor's First Mortgage dated June 26, 1916, and the proposed deed of release and satisfaction of mortgage from Irving Trust Company, as Trustee under the debtor's General and Refunding Mortgage, executed February 29, 1932, as of

January 1, 1932 (annexed to this order as Exhibits "A," "B" and "C," respectively), are in proper form and sufficient when properly executed, acknowledged and delivered, to release, transfer to and revest in said Railroad Company all right, title and interest of the debtor's Trustees and of said Trustees under the debtor's said mortgages, in and to all of the business, assets and property dealt with by the plan of reorganization, free from any title or lien of the debtor's Trustees and said mortgages, are consistent with and conform to the provisions of the plan of reorganization, are necessary and appropriate to the putting into effect and carrying out the plan, and should be approved;

(e) The proposed agreement, attached to this order as "Exhibit D," provides for the assumption of obligations, liabilities, contracts, agreements and leases which are to be assumed by the reorganized company, pursuant to the plan of reorganization, is consistent with and conforms to the plan of reorganization, and should be approved;

(f) The Interstate Commerce Commission, by its order dated October 24, 1944, in Finance Docket #10913, has authorized the revesting in The Western Pacific Railroad Company of the business, assets and property constituting the estate of the debtor and the issue of securities and the assumption of obligations by The Western Pacific Railroad Company to the extent contemplated by the plan of reorganization and by this order; said order of the Commission also approves and authorizes the adjustment or compromise of the claims of the

Reconstruction Finance Corporation against the debtor and its estate, pursuant to the applicable provisions of the Reconstruction Finance Corporation Act and said plan; said order of the Commission authorizes the issue of said securities as subject to Section 77(f) of the Bankruptcy Act, Section 20a of the Interstate Commerce Act and the applicable provisions of the Reconstruction Finance Corporation Act; said securities and the issue thereof are specifically exempt from the provisions of the Securities Act of 1933, under the terms of Section 3(a)(6) of said act and subsection (f) of Section 77 of the Bankruptcy Act and are specifically exempt from the provisions of the Trust Indenture Act of 1939, under the terms of Section 304(a)(4) of said act, and said action by the Commission satisfies the statutory requirements for such issue and no other or further authorization of any other governmental commission, agency or body, federal or state, is necessary or required;

(g) The issuance, transfer and exchange of the securities and the making, delivery and filing of the instruments of transfer or conveyance issued, transferred, exchanged, made, delivered or filed, pursuant to the plan of reorganization, the order of the Commission referred to in subparagraph (f) above, or this order, are to make effective a plan of reorganization confirmed under the Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States," approved July 1, 1898, as amended.

Now, Therefore, it is hereby Ordered, Adjudged and Decreed:

1. The form and provisions of each of the following instruments are hereby approved:

(a) the deed from the debtor's Trustees to The Western Pacific Railroad Company, attached to this order as "Exhibit A";

(b) the deed of release and satisfaction of mortgage from Crocker First National Bank of San Francisco and Samuel Armstrong, as Trustees under the debtor's First Mortgage, to The Western Pacific Railroad Company, attached to this order as "Exhibit B";

(c) the deed of release and satisfaction of mortgage from Irving Trust Company, as Trustee under the debtor's General and Refunding Mortgage, to The Western Pacific Railroad Company, attached to this order as "Exhibit C."

2. The arrangements made by the Reorganization Committee with Guaranty Trust Company of New York, for the services of said Company as depositary and exchange agent and the proposed letter of instructions to said Company relating to the deposit and exchange of securities (submitted at the hearing upon said petition and attached to this order as Exhibit "F"), are approved.

3. The Western Pacific Railroad Company is hereby authorized and directed to file or cause to be filed, on or before December 28, 1944, the Cer-

tificate of Amendment to its Articles of Incorporation, heretofore approved by order of this Court entered September 25, 1944, with the Secretary of State of California and, in due course, to file copies thereof, as may be required by law, with the Secretaries of State of Nevada and Utah and in the several counties of the States of California, Nevada and Utah in which the railroad and properties of the debtor are located.

4. T. M. Schumacher and Sidney M. Ehrmán, Trustees herein, are hereby authorized and directed to execute, acknowledge and deliver to The Western Pacific Railroad Company, on or before December 28, 1944, as requested by the Reorganization Committee, a deed, substantially in the form attached to this order as "Exhibit A" and approved herein, releasing and transferring to The Western Pacific Railroad Company, as of 12:01 a.m., Pacific War Time, on December 29, 1944, title to all property, rights and interests of every kind and description held by them as such Trustees, and are further authorized and directed thereafter to execute, acknowledge and deliver all such other conveyances, bills of sale, assignments and other instruments as may be necessary or proper to release, convey, assign or transfer to said Railroad Company, their entire right, title and interest in and to all of the business, assets and property of said Railroad Company.

5. Crocker First National Bank of San Francisco and Samuel Armstrong, as Trustees under

the First Mortgage dated June 26, 1916, executed by the debtor to First Federal Trust Company and Henry E. Cooper, Trustees (Crocker First National Bank of San Francisco and Samuel Armstrong, successor Trustees), are hereby authorized and directed to execute, acknowledge and deliver to The Western Pacific Railroad Company, on or before December 28, 1944, as requested by the Reorganization Committee, a deed releasing and satisfying, as of 12:01 a.m., Pacific War Time, on December 29, 1944, said First Mortgage of the debtor and all instruments supplemental or amendatory thereto, substantially in the form attached to this order as "Exhibit B" and approved herein, to transfer, convey and deliver to said Railroad Company, all moneys, credits, securities, evidences of indebtedness, choses in action, shares of stock, and all other property, rights and interest of every kind and description held by them as Trustees under said Mortgage and instruments supplemental or amendatory thereto, and to execute and deliver all such other conveyances, bills of sale, assignments and other instruments as may be necessary or proper for these purposes.

6. Irving Trust Company of New York, as Trustee under the debtor's General and Refunding Mortgage executed February 29, 1932, as of January 1, 1932, by the debtor to The Chase National Bank of the City of New York, Trustee (Irving Trust Company, successor Trustee), is hereby authorized and directed to execute, acknowledge and

deliver to The Western Pacific Railroad Company, on or before December 28, 1944, as requested by the Reorganization Committee, a deed releasing and satisfying, as of 12:01 a.m., Pacific War Time, on December 29, 1944, said General and Refunding Mortgage of the debtor and all instruments supplemental or amendatory thereto, substantially in the form attached to this order as "Exhibit C" and approved herein, to transfer, convey and deliver to said Railroad Company all moneys, credits, securities, evidences of indebtedness, choses in action, shares of stock, and all other property, rights and interests of every kind and description held by it as Trustee under said Mortgage and instruments supplemental or amendatory thereto, and to execute and deliver all such other conveyances, bills of sale, assignments and other instruments as may be necessary or proper for these purposes.

7. Whether executed before or after the date of consummation of the plan of reorganization, each of the deeds of release and satisfaction made pursuant to paragraphs "5" and "6" of this order by the trustees of the mortgages mentioned in said paragraphs, shall be effective as of the date of consummation of said plan and as of that date, each of said trustees shall be discharged and relieved of all obligations, liabilities, responsibilities and duties with respect to the particular mortgage or deed of trust and all indentures supplemental thereto, under which such trustee is acting.

8. The Western Pacific Railroad Company and

its proper officers are hereby authorized and directed to execute and deliver each and every of the following agreements and indentures, on or before December 28, 1944, as requested by the Reorganization Committee:

(a) agreement providing for the assumption of certain obligations, liabilities, contracts, agreements and leases of the debtor and the debtor's Trustees, substantially in the form attached to this order as "Exhibit D," the form and provisions of which are hereby approved;

(b) the Indenture relating to the First Mortgage Bonds, referred to in said petition, in the form submitted to this Court upon the hearing on said petition, which Indenture is found to be substantially in the form approved by order of this Court entered September 25, 1944; said Indenture to be deemed effective at 12:01 a.m., Pacific War Time, on December 29, 1944, coincident with the effective date of the deed from debtor's Trustees and the releases from existing mortgage trustees as provided in paragraphs "4," "5" and "6" of this order;

(c) the Indenture relating to the General Mortgage Income Bonds, referred to in said petition, in the form submitted to this Court upon the hearing of said petition, which Indenture is found to be substantially in the form approved by order of this Court entered September 25, 1944; said Indenture to be deemed effective at 12:01 a.m., Pacific War Time, on December 29, 1944, coincident with the effective date of the deed from debtor's Trustees

and the releases from existing mortgage trustees as provided in paragraphs "4," "5" and "6" of this order, but immediately following and subject to the taking effect of the Indenture referred to in subdivision (b) of this paragraph 8;

(d) the Scrip Agreement referred to in said petition, substantially in the form submitted to this Court upon the hearing of said petition, which Agreement is found to be substantially in the form approved by order of this Court entered October 23, 1944;

(e) the salary agreement substantially in the form attached to this order as "Exhibit E," the form and provisions of which are hereby approved.

9. The Western Pacific Railroad Company shall assume and agree to perform all contracts, leases and agreements made or entered into by the debtor in possession or by the debtor's Trustees and remaining in effect on the date of the actual delivery of possession by said Trustees and the actual termination of the responsibility of the debtor's Trustees for the operation of the debtor's properties, as hereinafter provided in this order, and which have heretofore been assumed or not disaffirmed by said Trustees, which remain in effect on December 31, 1944, together with the expenses of this reorganization as allowed by the Court within the maximum fixed by the Interstate Commerce Commission. Without limitation of the generality of the duties imposed on The Western Pacific Railroad Company as above provided, it shall specifically assume and

agree to perform the obligations of the Trustees in respect of the following:

(a) \$1,235,000 unpaid balance, principal amount of Three Per Cent. Equipment Trust Certificates, Series of 1937, issued February 1, 1937, under Agreement of same date, between J. T. Harrigan and F. E. Egly, Vendors, with Central Hanover Bank and Trust Company, Trustee, and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor.

(b) \$1,855,000 unpaid balance, principal amount of One and Three-Quarters Per Cent Equipment Trust Certificates, Series of 1941, issued August 1, 1941, under Agreement of same date, between M. J. Suydam and F. W. Walter, Vendors, with Central Hanover Bank and Trust Company, Trustee, and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor.

(c) Conditional Sale Agreement, dated as of May 25, 1943, between Lima Locomotive Works, Incorporated, and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor, relating to the purchase on monthly installment plan of six steam freight locomotives.

(d) Conditional Sale Agreement, dated as of June 21, 1943, between Electro-Motive Division, General Motors Corporation and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property

of The Western Pacific Railroad Company, Debtor, relating to the purchase on monthly installment plan of three 5400 H.P. diesel electric freight locomotives.

(e) Conditional Sale Agreement, dated as of June 1, 1944, between The Chase National Bank of the City of New York and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor, relating to the purchase on monthly installment plan of six 5400 H.P. diesel electric freight locomotives.

And, further, without limitation of the generality of the obligations hereinabove imposed upon The Western Pacific Railroad Company, that company shall (a) specifically assume and agree to pay in cash the face amount of any and all outstanding first mortgage bond coupons which matured on or prior to September 1, 1933, and had not theretofore been presented for payment, being the coupons which this Court by orders of March 11, 1936, and March 20, 1936, authorized The Chase National Bank of the City of New York to pay from funds which had been deposited with it by the debtor, and (b) assume liability for, and pay in due course, any and all taxes lawfully due to the United States from the debtor or the debtor's Trustees for any taxable period prior to January 1, 1945, whether or not proof thereof was made in said proceeding and without prejudice by reason of such proof not having been made. The above ordered assumption and adoption shall be evidenced by the execution by

said Railroad Company of the agreement of assumption referred to in paragraph "8(a)" above and of such other instruments of assumption as may be appropriate; and said Railroad Company shall succeed to all rights, privileges, liabilities and duties of the debtor or the debtor's Trustees under such contracts, leases and agreements; provided, however, that this order shall not be construed as a modification of any former orders of this Court barring or settling claims against the debtor or the debtor's Trustees, and said Railroad Company shall assume only the valid and outstanding obligations and liabilities of the debtor or the debtor's Trustees, other than unsecured claims against the debtor not entitled to priority over existing mortgages, which unsecured claims are hereby cancelled and discharged, and only such obligations and liabilities as are preserved under the plan of reorganization and are not limited or discharged by the prior orders of this Court.

10. The Western Pacific Railroad Company shall pay, in such amounts as have heretofore been, or shall hereafter be determined by this Court, but only to the extent that the same shall not have been paid by the debtor's Trustees, all expenses and costs of administration of this proceeding, including, without limiting the generality of the foregoing, all allowances of compensation for services heretofore or hereafter rendered and reimbursement of expenses heretofore or hereafter incurred in connection with this reorganization proceeding or

the plan of reorganization, subsequent to October 31, 1939; provided, however, that said Railroad Company is authorized to pay, in its discretion, without further order of this Court and regardless of amount, all rentals, costs and expenses growing out of the joint use of the property of other carriers, and all taxes, and all other obligations (not including any such allowances of compensation for services or reimbursement of expenses) incurred subsequent to August 2, 1935, by the debtor or the debtor's Trustees in the ordinary course of business in the operation of the aforesaid business, assets or property, pursuant to the general authorizations granted by this Court.

11. The date for the consummation of the plan of reorganization, and the date upon which the first mortgage bondholders and secured creditors of the debtor shall be entitled to receive in exchange for their old securities, the new securities and adjustment payments under the plan, as heretofore approved and authorized by this Court, is hereby fixed as December 29, 1944; all of the business, assets and property constituting the debtor's estate, of every kind and character, real, personal and mixed, and all of the right, title and interest therein of T. M. Schumacher and Sidney M. Ehrman, as Trustees herein, shall vest in and be and become the absolute property of The Western Pacific Railroad Company on said date, free and clear of all rights, claims, liens and interests of said Trustees, the former stockholders and creditors of the debtor, and

of all other persons, firms and corporations whatsoever, except as is otherwise provided in this order, and the said Railroad Company shall thereupon be forever released and discharged from all of its debts, obligations and liabilities, except as herein provided; and The Western Pacific Railroad Company shall, on said date

(a) execute, issue and deliver, or cause to be made available for delivery through said depository and exchange agent, in accordance with the plan of reorganization and the orders of this Court herein, to holders of the debtor's existing first mortgage bonds, or upon their order, upon presentation and surrender of such bonds, together with all interest coupons due after September 1, 1933 (upon which surrender said first mortgage bonds and interest coupons shall be cancelled), said Railroad Company's General Mortgage 4½% Income Bonds, Series A, Preferred Stock, Series A, common stock (including the authorized scrip for fractional interests), and the adjustment payments heretofore ordered by this Court (for each \$1,000 principal amount of existing first mortgage bonds so surrendered, \$400 principal amount of General Mortgage 4½% Income Bonds, Series A; \$600 face amount of Preferred Stock, Series A, 4.67 shares of common stock, and the adjustment payments to be made at that time as provided in the order of this Court dated September 25, 1944);

(b) execute, issue and deliver, or cause to be made available for delivery through said depository and exchange agent, to holders of scrip certificates

for the debtor's existing first mortgage bonds in the aggregate principal amount of \$300, or upon their order, upon surrender of said certificates in lots of \$100 principal amount or any multiple thereof, said Railroad Company's General Mortgage 4½% Income Bonds, Series A, Preferred Stock, Series A, common stock (including authorized scrip for fractional interests) and the adjustment payments heretofore ordered by this Court upon the same basis as such securities are issuable to holders of the debtor's existing first mortgage bonds, as provided in subparagraph (a), of this paragraph 11.

(c) execute, issue and deliver, or cause to be made available for delivery through said depository and exchange agent, to the holder or holders of ten of the debtor's existing first mortgage bonds, namely, Nos. M3595, M3596, M21612, M21613, M21614, M21615, M21616, M21618, M21619 and M21620, or upon their order, upon presentation and surrender of such bonds with coupons maturing on and after September 1, 1935, attached, notwithstanding the provisions of subparagraph (a), of this paragraph 11, only said Railroad Company's General Mortgage 4½% Income Bonds, Series A, Preferred Stock, Series A, common stock (including authorized scrip for fractional interests) and the adjustment payments heretofore ordered by this Court, as follows for each said bond, \$400 principal amount of General Mortgage 4½% Income Bonds, Series A, \$600 par value of Preferred Stock, Series A, 3.356 shares of common stock and the adjustment

payments as provided in the order of this Court dated September 25, 1944; and execute, issue and deliver or cause to be made available for delivery through said depository and exchange agent to The Western Pacific Railroad Corporation, or upon its order, in respect of coupons numbered 36 and 37 formerly attached to each of said bonds, upon presentation and surrender of such coupons, said Railroad Company's common stock (including authorized scrip for fractional interests) and the adjustment payments heretofore ordered by this Court, as follows: for each said coupon, .437 shares of common stock and the adjustment payment as provided in the order of this Court dated September 25, 1944.

(d) execute, issue and deliver, or cause to be made available for delivery through said depository and exchange agent, in accordance with the plan of reorganization and the orders of this Court herein, to Reconstruction Finance Corporation, \$10,000,000 principal amount of said Railroad Company's First Mortgage 4% Bonds, Series A, bearing interest from January 1, 1945, \$1,185,200 principal amount of its General Mortgage 4½% Income Bonds, Series A, \$1,777,800 par value of its Preferred Stock, Series A, 15,788 shares of its common stock, and the adjustment payments to be made at that time as provided in the order of this Court dated September 25, 1944; and Reconstruction Finance Corporation shall, on such date, surrender and pay over to said Railroad Company, all out-

standing Trustees' certificates of indebtedness heretofore at any time issued by the debtor's Trustees to Reconstruction Finance Corporation, \$6,000,000 of cash collateral heretofore deposited with Reconstruction Finance Corporation by the debtor's Trustees as security for said Trustees' certificates, all notes and other evidences of indebtedness of the debtor held by Reconstruction Finance Corporation, all bonds and other obligations of the debtor held by Reconstruction Finance Corporation as collateral security for said indebtedness, and all other collateral pledged by the debtor as security for the notes held by Reconstruction Finance Corporation; and Reconstruction Finance Corporation shall, on such date, pay over to said Railroad Company the further sum of \$1,075,000 in cash, less such sum as may be required for the payment of interest upon said Trustees' certificates to December 29, 1944, and the payment of an amount equal to interest on said \$10,000,000 of First Mortgage 4% Bonds from said date to January 1, 1945;

(e) execute, issue and deliver, or cause to be made available for delivery through said depository and exchange agent, in accordance with the plan of reorganization and the orders of this Court herein, to The Railroad Credit Corporation, or upon its order, \$154,080 principal amount of said Railroad Company's General Mortgage 4½% Income Bonds, Series A, \$241,640 par value of its Preferred Stock, Series A, not more than 35,425 shares of common stock (including the authorized Scrip for fractional interests) and \$72.00 in cash,

and the adjustment payments to be made at that time as provided in the order of this Court dated September 25, 1944, upon surrender by The Railroad Credit Corporation of all notes and other evidences of indebtedness of the debtor held by The Railroad Credit Corporation and of all bonds and other obligations of the debtor held by The Railroad Credit Corporation as collateral security for said indebtedness and all other collateral pledged by the debtor as security for the notes held by The Railroad Credit Corporation (other than the pledge of the distributive shares of the Railroad Company and its subsidiaries under the the marshalling and distributing plan of 1931); provided, however, that of the maximum amount of common stock so authorized to be issued to The Railroad Credit Corporation, only so much shall be issued as is within the limitation fixed by the order of this Court made September 14, 1944, providing for the reduction of such common stock on account of sums applied by The Railroad Credit Corporation under the marshalling and distributing plan in reduction of its claims, but in the event that said order of September 14, 1944, shall be modified or reversed upon appeal so as to entitle The Railroad Credit Corporation to receive additional common stock within the maximum limit hereinabove stated, then The Western Pacific Railroad Company shall execute, issue and deliver such additional common stock without further order of this Court and without further consideration other

than the surrender by The Railroad Credit Corporation at the time of the consummation of the plan of its secured notes of the debtor and the collateral thereto to the extent and in the manner hereinabove provided;

(f) execute, issue and deliver, or cause to be made available for delivery through said depository and exchange agent, in accordance with the plan of reorganization and the orders of this Court herein, to A. C. James Co., or upon its order, \$163,680 principal amount of said Railroad Company's General Mortgage 4½% Income Bonds, Series A, (including the authorized Scrip for fractional interests) \$256,700 par value of its Preferred Stock, Series A, 37,635 shares of its common stock and \$100.00 in cash, and the adjustment payments to be made at that time as provided in the order of this Court dated September 25, 1944, upon surrender of all notes and other evidences of indebtedness of the debtor to A. C. James Co., all bonds and other obligations of the debtor held as collateral security for said indebtedness, and all other collateral pledged by the debtor as security for the notes to A. C. James Co.

12. Notwithstanding the provisions of the foregoing paragraphs "4" and "11" of this order, the debtor's Trustees are authorized and directed to continue their control and operation of the debtor's business and properties until 12:00 o'clock midnight, Pacific War Time, on December 31, 1944, and until such time, to retain possession of so much of the funds and properties of the debtor as

may be necessary for the purposes of such control and operation; provided, however, that all right and duty of such Trustees to possess, control or operate said business and properties shall cease at 12:00 o'clock midnight, on December 31, 1944.

13. Any lien which may attach to the property subjected to the lien of the mortgages to be executed and delivered by The Western Pacific Railroad Company pursuant to subparagraphs (b) and (c) of Paragraph 8 of this order, during the period between the execution and delivery thereof and the completion of the recording of said mortgages, shall be subordinate to the lien of such mortgages, unless any such lien so attaching would be prior to the lien of such mortgages if the same had been recorded; and this Court reserves jurisdiction over the business, assets, franchises and property to be vested in The Western Pacific Railroad Company as provided herein, and of any claims to liens which may be asserted against the same, to the extent necessary to give effect to the provisions of this paragraph.

14. Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, as the Reorganization Committee, are hereby authorized and directed to prepare a notice to the holders of first mortgage bonds and secured notes of the debtor, in such form as the Reorganization Committee shall determine, notifying such creditors that they are entitled to present the obligations of the debtor now held by them

to the Guaranty Trust Company of New York, the depositary and exchange agent designated by the Court, and to receive, on and after December 29, 1944, for such obligations, the new securities and adjustment payments to which they are entitled under the plan; said Reorganization Committee shall publish said notice twice a week for two successive weeks prior to December 29, 1944, in one daily newspaper of general circulation in the City of San Francisco, California, and in one daily newspaper of general circulation in the City of New York, New York. Said Reorganization Committee shall also mail a copy of said notice at least ten days prior to December 29, 1944, to each of the first mortgage bondholders and secured creditors of the debtor so far as the post office addresses of such security holders are available to the Reorganization Committee.

15. Until the further order of this Court, and except as the creation of liens is specifically provided for or permitted by this Court, all persons, firms or corporations, whatsoever or wheresoever situated, located or domiciled, are hereby restrained or enjoined from interfering with, attaching, garnishing, levying upon, granting or enforcing liens against or upon, or in any manner whatsoever disturbing any part of the assets, goods, moneys, railroad, properties and premises belong to or in the possession of said Railroad Company on and after the time specified in paragraph "11" hereof, by reason of or growing out of any obligation or obli-

gations heretofore incurred by the debtor or the debtor's Trustees herein.

16. The Reorganization Committee and The Western Pacific Railroad Company shall have full power and authority to and shall put into effect and carry out the reorganization plan and the orders of this Court, including this order, relative thereto, the laws of any state or the decision or order of any state authority to the contrary notwithstanding.

17. For the purpose of the determination and application of the available net income of the reorganized company for the calendar year 1944, pursuant to subdivision "L" of the plan of reorganization, and for the determination of amounts payable as interest on the General Mortgage 4½% Income Bonds, Series A, of the reorganized company out of available net income for the calendar year 1944, and for the determination of earnings for the calendar year 1944, available for determination and payment by the directors of dividends upon the preferred and common stocks of the reorganized company, the operation by the debtor's Trustees of the properties and estate of the debtor during the calendar year 1944, shall be deemed to be for the account of the reorganized company; and the directors of the reorganized company are expressly authorized and directed to proceed with the determination of the available net income for the calendar year 1944, and the application of such

available net income in the same manner as if such operation had actually been carried on in the calendar year 1944 by the reorganized company.

18. T. M. Schumacher and Sidney M. Ehrman, Trustees herein, shall render their final account to this Court on or before May 1, 1945, and The Western Pacific Railroad Company shall pay from time to time their compensation and expenses, including compensation and disbursements of counsel acting for said trustees, as heretofore fixed by order of this Court until such date.

19. This order and all transactions pursuant hereto shall be without prejudice to any rights or claims of right of Reconstruction Finance Corporation and The Railroad Credit Corporation in and to any collateral pledged by persons other than the debtor as security for the notes of the debtor held by Reconstruction Finance Corporation and The Railroad Credit Corporation respectively, and without prejudice to any right or claim of right of The Railroad Credit Corporation under the terms of the plan of reorganization to retain distribution credits under the marshalling and refunding plan accruing to the debtor and its subsidiaries subsequent to the consummation of the plan of reorganization.

20. This Court reserves jurisdiction for all purposes necessary to put into effect and carry out this order and the plan of reorganization, including, without limiting the generality of this reservation, the right to enter, upon such notice as this Court

may direct, any further order or orders terminating the right to receive any securities or payments of cash under the plan of reorganization; and this Court expressly reserves jurisdiction to determine all costs and expenses of administration, including the amounts to be paid as compensation for services heretofore or hereafter rendered or reimbursement for expenses heretofore or hereafter incurred by the Reorganization Committee and its attorneys, or by any other person, firm or corporation, in connection with this proceeding and the plan of reorganization, and generally in connection with putting into effect and carrying out the plan of reorganization.

Dated: Nov. 27, 1944.

A. F. ST. SURE,
District Judge.

EXHIBIT "A"

Trustees' Deed

Know All Men by These Presents, that the Grantors T. M. Schumacher and Sidney M. Ehrman, as Trustees of the property of The Western Pacific Railroad Company, a railroad corporation organized and existing under the laws of the State of California (said corporation being referred to herein as the "Railroad Company"), being in possession of and operating the property of the Railroad Company, including its property in the States of California, Nevada and Utah, under the juris-

diction of the United States District Court, for the Northern District of California, Southern Division, for and in consideration of and in compliance with the orders and directions of the said Court in the reorganization proceedings mentioned below, have remised, released, transferred, conveyed and quit-claimed, and by these presents do remise, release, transfer, convey and quitclaim unto the Grantee, The Western Pacific Railroad Company, the said Railroad Company (the reorganized corporation under the Plan of Reorganization hereinafter mentioned), its successors, grantees and assigns, all of the property, real, personal and mixed, of every kind and nature of the said Railroad Company now vested in, held, possessed, used or controlled by said T. M. Schumacher and Sidney M. Ehrman, as such Trustees, and, without in anywise limiting the generality or all-inclusive scope of the foregoing description, including the following:

All of the lines of railroad heretofore owned or operated by the said Railroad Company and now vested in, held, possessed used or controlled by the Grantors, together with all of the estates, rights, powers, privileges, franchises, immunities and all other property used in connection therewith or in any way pertaining thereto.

All of the Railroad Company's estate, right, title, interest, terms and remainders of terms, franchises, privileges and rights of action of whatsoever name and nature in law or in equity in any and all track-age, terminal or operating contracts or agreements or

leases, and all extensions or renewals thereof, used or usable in connection with the aforesaid lines of railroad or appertaining thereto; all rights of way, station grounds, railroad yards, terminal grounds, and other lands, tenements and hereditaments of whatever kind or description; also all main, branch, cut-off, spur, industrial, switch, connecting, storage, yard or terminal tracks, easements estates, superstructures, roadbeds, bridges, trestles, culverts, viaducts, buildings, depots, stations, office buildings, stock yards, warehouses, elevators, car houses, engine houses, freight houses, machine shops and other shops, turntables, fuel stations, water stations, signals, interlocking plants, telegraph and telephone lines, fences, docks, structures, improvements and fixtures; and all mechanical equipment, machinery, tools, implements, furniture, supplies, materials, and other chattels, all locomotives and engines however propelled or operated, passenger, freight or other railway cars, derricks and other work equipment or cars, buses, trucks, automobiles and other automotive machines, and any and all other rolling stock and vehicles; and all other property of every kind and nature, in anywise or at any time, owned or used or useful in connection with the operation of the aforesaid lines of railroad or the carrying on of the business and affairs of the Railroad Company either by the Railroad Company or by the Grantors, as such Trustees, and now forming a part of the property and estate of the Railroad Company now held by the Grantors as such Trustees;

together with all of the rights, powers, privileges, franchises, immunities, and other property of whatsoever kind so vested, held, possessed, used or controlled either in connection with the operation of the aforesaid lines of railroad or otherwise, including all choses in action and all interests of the Grantors, as such Trustees, in all suits and proceedings wheresoever brought and by whomsoever instituted now pending or which may hereafter be commenced prior to the final discharge of the Grantors as such Trustees.

This conveyance is made by the Grantors pursuant to a Plan of Reorganization of The Western Pacific Railroad Company, confirmed by order of the District Court of the United States for the Northern District of California, Southern Division, in proceedings for the reorganization of a railroad under Section 77 of the Bankruptcy Act, as amended, entitled "In the Matter of The Western Pacific Railroad Company, Debtor, No. 26591-S," and in connection with and for the purpose of consummating a Plan of Reorganization in said proceedings, and pursuant to the direction, designation and authorization of the Court contained in the order entered, 1944, in said reorganization proceedings.

And said Grantors hereby agree that they will, on the request of The Western Pacific Railroad Company and at its expense, execute, acknowledge and deliver all and every such further instruments as may be necessary or proper to confirm and fur-

ther evidence the release, transfer and conveyance of the aforesaid property.

This instrument is executed by and shall be binding upon the Grantors as Trustees of the property of said Railroad Company for the uses and purposes above set forth and referred to, and shall be effective as of 12:01 a.m. Pacific War Time, December 29, 1944; provided, however, that the Grantors shall retain possession of so much of the property and assets hereby conveyed as may be necessary or convenient to enable the Grantors as directed by said order of, 1944, in the reorganization proceedings, to continue, as Trustees, to carry on and operate the railroad business of the Railroad Company until midnight December 31, 1944, at which time all right of the Grantors to retain possession or control of said property and assets shall cease and terminate.

In Testimony Whereof, the Grantors as such Trustees have executed this instrument this day of December, 1944.

.....[L. S.]
.....[L. S.]

As Trustees of the Property
of The Western Pacific
Railroad Company.

In the presence of:
.....

[Appropriate acknowledgments to be supplied]

EXHIBIT "B"

Satisfaction of Mortgage

Whereas, The Western Pacific Railroad Company, a corporation organized and existing under the laws of the State of California, executed and delivered a Mortgage or Deed of Trust dated June 26, 1916, to First Federal Trust Company and Henry E. Cooper, as Trustees, to secure an issue of First Mortgage bonds of The Western Pacific Railroad Company, limited to the aggregate principal amount of \$50,000,000 at any one time outstanding:

Whereas, according to the records of the undersigned, said Mortgage or Deed of Trust was recorded:

on July 17, 1916, in Liber 451 of Mortgages (new series) page 1, in the office of the County Recorder of the City and County of San Francisco, State of California,

on July 17, 1916, in Liber 1124 of Mortgages, page 67, records of Alameda County, California,

on July 17, 1916, in Book B, Volume 125 of Mortgages, pages 245, San Joaquin County Records, California,

on July 17, 1916, in Book 177 of Mortgages, page 163, Sacramento County Records, California,

on July 17, 1916, in Book 35 of Mortgages, page 100, Sutter County Records, California,

on July 17, 1916, in Volume 31 of Mortgages, page 97, Yuba County Records, California,
on July 17, 1916, in Book 80, page 1 of Mortgages, Butte County Records, California,
on July 17, 1916, in Volume 15 of Mortgages, page 395, Plumas County Records, California,
on July 17, 1916, in Book O of Mortgages, page 15 et seq., Lassen County Records, California,
on July 17, 1916, in Book 26 of Mortgages, page 293, Records of Washoe County, Nevada,
on July 18, 1916, in Book K, page 46 of Mortgages and in Book F, page 9 of Chattel Mortgages, Records of Humboldt County, Nevada,
on July 24, 1916, in Book 6 of Mortgages, page 721, and in Book 3, page 1, of Chattel Mortgages, Records of Lander County, Nevada,
on July 18, 1916, in Liber E of Mortgages, page 346, and in Liber B of chattel Mortgages, page 3, Records of Eureka County, Nevada,
on July 17, 1916, in Book 8 of Real Mortgages, page 201, and in Book 6 of Chattel Mortgages, page 290, Records of Elko County, Nevada,
on July 18, 1916, in Book J of Mortgages, page 141, Tooele County, Utah,
on July 18, 1916, in Book 7-Q of Mortgages, page 85, County of Salt Lake Records, Utah,
on July 19, 1916, in Book 5 of Mortgages, page 324, County of Box Elder Records, Utah,

on July 18, 1916, as a Chattel Mortgage, in Tooele County Records, Utah,

on July 18, 1916, as a Chattel Mortgage in Salt Lake County Records, Utah,

on July 19, 1916, as a Chattel Mortgage in Box Elder County Records, Utah,

on December 7, 1916, in Liber M of Mortgages, page 177, Records of Sierra County, California,

on November 13, 1917, in Volume 226 of Mortgages, page 383, Records of Santa Clara County, California,

on July 17, 1916, in Book 9 of Chattel Mortgages, page 1, Records of Washoe County, Nevada.

Whereas, Crocker First National Bank of San Francisco, a corporation organized and existing under the laws of the United States, and Samuel Armstrong, are now the Trustees under said Mortgage or Deed of Trust, Crocker First National Bank of San Francisco having become successor corporate Trustee on May 31, 1934, and Samuel Armstrong having become successor individual Trustee on January 28, 1935;

Whereas, the District Court of the United States for the Northern District of California, Southern Division, in proceedings for reorganization of The Western Pacific Railroad Company under Section 77 of the Bankruptcy Act, as amended, entitled "In

the Matter of The Western Pacific Railroad Company, Debtor," Docket No. 26591-S, by order entered October 11, 1943, confirmed a Plan of Reorganization of The Western Pacific Railroad Company, which Plan provides, among other things, for the issuance of new securities to the holders of bonds under said Mortgage or Deed of Trust in payment and satisfaction of their bonds, and the release and cancellation of mortgages on the property of The Western Pacific Railroad Company; and

Whereas, by order entered in said proceedings on, 1944, said Court directed said Crocker First National Bank of San Francisco and Samuel Armstrong, as Trustees under said Mortgage or deed of Trust to execute and deliver to The Western Pacific Railroad Company, a satisfaction and release of said Mortgage or Deed of Trust;

Now, Therefore, in consideration of the premises, Crocker First National Bank of San Francisco and Samuel Armstrong, as Trustees under said Mortgage or Deed of Trust, pursuant to said order dated, 1944, hereby certify that, effective December 29, 1944, at 12:01 a.m., Pacific War Time, said Mortgage or Deed of Trust, has been satisfied and discharged and do hereby cancel and discharge said Mortgage or Deed of Trust and consent and direct that said Mortgage or Deed of Trust be discharged of record in the states and counties in which the same has been recorded, and do hereby release, remise, quitclaim, transfer, re-

convey and reassign to The Western Pacific Railroad Company, all of the property, both real and personal, mortgaged, conveyed or pledged by said Mortgage or Deed of Trust and now held by said Trustees thereunder;

And said Crocker First National Bank of San Francisco and Samuel Armstrong as Trustees, as aforesaid, hereby agree that they will, on the request of The Western Pacific Railroad Company and at its expense, execute, acknowledge and deliver all and every such further instruments as may be necessary or proper to cancel and discharge said Mortgage or Deed of Trust, and to have the same satisfied of record.

In Witness Whereof, Crocker First National Bank of San Francisco, as such successor Trustee, by its officers hereunto duly authorized, has executed the foregoing instrument and caused its corporate seal to be hereunto affixed, and Samuel Armstrong as successor Trustee has hereunto set his hand and seal, this day of December, 1944.

CROCKER FIRST NATIONAL
BANK OF SAN FRANCISCO,
as Successor Trustee.

By.....

Vice President.

Attest:

.....

.....

As Successor Trustee.

[Appropriate acknowledgments to be supplied.]

EXHIBIT "C"

Satisfaction of Mortgage

Whereas, The Western Pacific Railroad Company, a corporation organized and existing under the laws of the State of California, executed and delivered a Mortgage or Deed of Trust dated as of January 1, 1932, to The Chase National Bank of The City of New York, as Trustee, to secure an issue of General and Refunding Mortgage Bonds of The Western Pacific Railroad Company, limited to an aggregate principal amount of \$100,000,000 at any one time outstanding;

Whereas, according to the records of the undersigned, said Mortgage or Deed of Trust was recorded:

on March 12, 1932, in Volume 2353, page 17 of the official records of the City and County of San Francisco, California,

on March 12, 1932, in Volume 25, page 80 of the official records of Sutter County, California,

on March 12, 1932, in Volume 22, page 225 of Mortgages in the County of Plumas, California,

on March 14, 1932, in Volume Z, page 211 of Mortgages in the County of Lassen, California,

on March 14, 1932, in Volume 12, page 375 of the official records of Yuba County, California,

on March 14, 1932, in Volume 4, page 423 of the official records of Modoc, California,

on March 15, 1932, in Volume 2792, page 101 of the official records of Alameda County, California,

on March 15, 1932, in Volume 319, page 1 of the official records of Sacramento County, California,

on March 15, 1932, in Volume 387, page 393 of the official records of San Joaquin, California,

on March 15, 1932, in Volume 604, page 365 of the official records of the County of Santa Clara, California,

on March 15, 1932, in Volume P, page 227 of Mortgages in the County of Sierra, California,

on March 15, 1932, in Volume 37, page 175 of the official records of Siskiyou County, California,

on March 17, 1932, in Volume 85, page 57 of the official records of Butte County, California,

on March 12, 1932, in Volume 1, page 277 of Chattel Mortgages in the County of Lander, Nevada,

on March 12, 1932, in Volume 2, pages 413-471 of Mortgages in the County of Elko, Nevada,

on March 12, 1932, in Volume A, page 238 of Mortgages in the County of Eureka, Nevada,

on March 12, 1932, in Volume 1, page 415 of Mortgages in the County of Pershing, Nevada,

on March 12, 1932, in Volume 56, page 250 of Mortgages in the County of Washoe, Nevada,

on March 18, 1932, in Volume 1, Page 525 of Mortgages in the County of Humboldt, Nevada,

on March 18, 1932, in Volume 36, page 428 of the records of Box Elder County, Utah,

on March 19, 1932, in Volume 103, page 155 of the records of Salt Lake County, Utah,

on April 12, 1932, in Volume P, page 1 of the records of Tooele County, Utah.

Whereas, Irving Trust Company is now the Trustee under said Mortgage or Deed of Trust, having become successor Trustee on November 13, 1936;

Whereas, the District Court of the United States for the Northern District of California, Southern Division, instituted proceedings for the Reorganization of The Western Pacific Railroad Company under Section 77 of the Bankruptcy Act, as amended, entitled "In the Matter of The Western Pacific Railroad Company, Debtor," Docket No. 26591-S, by order entered October 11, 1943, confirmed a Plan of Reorganization of The Western Pacific Railroad Company, which Plan, provides, among other things, for the issuance of new securities to the holders of bonds under such Mortgage or Deed of Trust in payment and satisfaction of their bonds and the release and cancellation of mortgages on the property of The Western Pacific Railroad Company; and

Whereas, by order entered in said proceedings on

....., 1944, said Court directed said Irving Trust Company, as Trustee under said Mortgage or Deed of Trust, to execute and deliver to The Western Pacific Railroad Company a satisfaction and release of said Mortgage or Deed of Trust;

Now, Therefore, in consideration of the premises Irving Trust Company, as Trustee under said Mortgage or Deed of Trust, pursuant to said order dated, 1944, hereby certifies that, effective December 29, 1944, at 12:01 a.m., Pacific War Time, said Mortgage or Deed of Trust, has been satisfied and discharged and does hereby cancel and discharge said Mortgage or Deed of Trust and consents and directs that said Mortgage or Deed of Trust be discharged of record in the states and counties in which the same has been recorded, and does hereby release, remise, quitclaim, transfer, reconvey and reassign to The Western Pacific Railroad Company all of the property, both real and personal, mortgaged, conveyed or pledged by said Mortgage or Deed of Trust and now held by said Trustee thereunder;

And said Irving Trust Company as Trustee, as aforesaid, hereby agrees that it will, on the request of The Western Pacific Railroad Company and at its expense, execute, acknowledge and deliver all and every such further instruments as may be necessary or proper to cancel and discharge said Mortgage or Deed of Trust and to have the same satisfied of record.

In Witness Whereof, Irving Trust Company, as

successor Trustee, by its officers hereunto duly authorized, has executed the foregoing instrument and caused its corporate seal to be hereunto affixed this day of December, 1944.

IRVING TRUST COMPANY,
as Successor Trustee.

By

Vice President.

Attest:

.

[Appropriate acknowledgment to be supplied.]

EXHIBIT "D"

Whereas, heretofore in a proceeding in the United States District Court for the Northern District of California, Southern Division, for the reorganization of a railroad under Section 77 of the Bankruptcy Act, as amended, entitled "In the Matter of The Western Pacific Railroad Company, Debtor," No. 26591-S, a Plan of Reorganization of The Western Pacific Railroad Company was approved and confirmed, and, pursuant to the provisions of said Plan of Reorganization, an order was entered on September 25, 1944, by said Court approving the use of the said debtor company, The Western Pacific Railroad Company, a corporation organized and existing under the laws of the State of California, as the reorganized company in carrying out said plan;

Whereas, the Interstate Commerce Commission, under date of October 24, 1944, in Docket #10913, made a report and order which, among other things,

approved and authorized the assumption by said The Western Pacific Railroad Company of obligations and liabilities as provided in said plan;

Whereas, pursuant to said Plan of Reorganization and to the order entered in said proceeding on, 1944, T. M. Schumacher and Sidney M. Ehrman, as Trustees of the property of said The Western Pacific Railroad Company, duly appointed in said proceedings (hereinafter called the "Trustees"), have, by deed dated December, 1944, remised, released, transferred, conveyed and quit-claimed to the undersigned, said The Western Pacific Railroad Company, all of the property, real, personal and mixed, of every kind and nature, vested in, held, possessed, used or controlled by said Trustees;

Now, Therefore, pursuant to the provisions of said order entered, 1944, and in consideration of the said release, transfer and conveyance by the Trustees, the undersigned The Western Pacific Railroad Company, for itself, its successors and assigns, makes this Agreement with said Trustees, for the benefit of said Trustees and of all other parties in interest in the above-entitled proceedings, under which agreement the undersigned does hereby:

1. Assume and agree to perform all contracts, leases and agreements made or entered into by the debtor in possession or by said Trustees and remaining in effect on December 31, 1944, and all contracts, leases and agreements of the debtor in effect on August 2, 1935, either assumed or not dis-

affirmed by said Trustees, which remain in effect on December 31, 1944, and expenses of reorganization allowed by the Court within the maximum fixed by the Interstate Commerce Commission;

2. Assume any and all outstanding current liabilities and obligations incurred by said Trustees and without limitation thereto, any and all liabilities or obligations of the debtor in possession of said Trustees with respect to claims for personal injury or death, for loss or damage to property and generally any and all liabilities and obligations with respect to claims of any character whether heretofore or hereafter asserted arising out of the possession, use or operation of the debtor's properties by said Trustees, or their conduct of the debtor's business, including liabilities and obligations hereafter arising up to midnight December 31, 1944.

3. Without limitation of the generality of the foregoing agreements in paragraphs 1 and 2 hereof, specifically undertake to defend at its own sole cost and expense all suits and proceedings, of whatsoever character, now or hereafter instituted against the Trustees, or either of them, arising out of the possession, use or operation of the debtor's properties by the Trustees or of their conduct of the debtor's business, and to assume the conduct of all suits and proceedings, of whatsoever character, heretofore or hereafter brought by the Trustees in the discharge of their duties and responsibilities as such, and, generally, to indemnify the Trustees and save them harmless against all expense, liability,

loss, judgments, claims and demands arising out of such suits or proceedings. It is the intent of the covenants in this paragraph 3 contained that The Western Pacific Railroad Company shall assume responsibility for all such suits and proceedings to which the Trustees, or either of them, are or shall become parties, to the same effect as if The Western Pacific Railroad Company instead of the Trustees had been party thereto in the first instance.

4. Without limitation of the generality of the foregoing agreements in Paragraphs 1 and 2 above, specifically assume and agree to perform the obligations of the Trustees in respect of the following:

(a) \$1,235,000 unpaid balance, principal amount of Three Per Cent. Equipment Trust Certificates, Series of 1937, issued February 1, 1937, under Agreement of same date, between J. T. Harrigan and F. E. Egly, Vendors, with Central Hanover Bank and Trust Company, Trustee, and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor.

(b) \$1,855,000 unpaid balance, principal amount of One and Three Quarters Per Cent Equipment Trust Certificates, Series of 1941, issued August 1, 1941, under Agreement of same date, between M. J. Suydam and F. W. Walter, Vendors, with Central Hanover Bank and Trust Company, Trustee, and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor.

(c) Conditional Sale Agreement, dated as of

May 25, 1943, between Lima Locomotive Works, Incorporated, and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor, relating to the purchase on monthly installment plan of six steam freight locomotives.

(d) Conditional Sale Agreement, dated as of June 21, 1943, between Electro-Motive Division, General Motors Corporation and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor, relating to the purchase on monthly installment plan of three 5400 H. P. diesel electric freight locomotives.

(e) Conditional Sale Agreement, dated as of June 1, 1944, between The Chase National Bank of the City of New York and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor, relating to the purchase on monthly installment plan of six 5400 H. P. diesel electric freight locomotives.

5. Without limitation of the generality of the foregoing agreements in Paragraphs 1 and 2 above, specifically assume and agree to pay in cash the face amount of any and all outstanding first mortgage bond coupons which matured on or prior to September 1, 1933, and had not theretofore been presented for payment; such coupons being those which the Court by orders of March 11, 1936, and March 20, 1936, authorized The Chase National Bank of the City of New York to pay from funds

which had been deposited with it by the debtor.

6. Without limitation of the generality of the foregoing agreements in Paragraphs 1 and 2 above, assume the liability for, and pay in due course, any and all taxes lawfully due to the United States from the debtor or the debtor's Trustees for any taxable period prior to January 1, 1945, whether or not proof thereof was made in the said proceeding and without prejudice by reason of such proof not having been made.

This agreement shall become effective on December 29, 1944, at 12:01 a.m., Pacific War Time.

In Witness Whereof, the undersigned has caused this instrument to be executed in its behalf by its President and its corporate seal to be hereunto affixed this day of December, 1944.

THE WESTERN PACIFIC
RAILROAD COMPANY,

By.....

President.

Attest:

.....

[Appropriate acknowledgment to be supplied.]

EXHIBIT "E"

....., 1944

Reconstruction Finance Corporation

Washington, D. C.

Dear Sirs:

In consideration of the acquisition by Reconstruction Finance Corporation (hereinafter called Re-

construction) of \$10,000,000 principal amount of The Western Pacific Railroad Company First Mortgage 4% Bonds, due January 1, 1974, issued or to be issued under a Mortgage, dated as of January 1, 1939, between The Western Pacific Railroad Company and Crocker First National Bank of San Francisco, Trustees, The Western Pacific Railroad Company (hereinafter called the Railroad) hereby agrees with and represents to Reconstruction as follows:

1. The term "compensation" as used in this Agreement shall include all salaries, fees, bonuses, commissions or other payments, direct or indirect, in money or otherwise, for personal services paid or to be paid by the Railroad.

2. There are attached hereto, and made a part hereof, four schedules, as follows:

(a) Schedule A, consisting of sheets, setting forth the compensation (excluding directors' fees shown in Schedule C) paid or to be paid to officers, directors and employees of the Railroad at a rate of \$4800 or more, per year;

(b) Schedule B, consisting of sheets, setting forth the average number of employees and the total compensation paid to officers and employees of the Railroad during the year 1943, as such information is classified in Schedule 561 in form A, Annual Reports filed with the Interstate Commerce Commission;

(c) Schedule C, consisting of sheets, setting forth the compensation paid or to be paid to

the Railroad's directors and members of Executive Committee in such capacities;

(d) Schedule D, consisting of sheets, setting forth the compensation paid or to be paid to officers, directors or employees of the Railroad by any company or companies controlling, or affiliated with or controlled by, the Railroad.

3. So long as any of said Bonds are held by Reconstruction, the Railroad will not—

(a) increase the compensation, either directly or by promotion to any office or position, of

(1) any officer, director or employee, paid or to be paid compensation at a rate of not more than \$4800 per year to a rate of more than \$4800 per year; or

(2) any officer, director or employee, paid or to be paid compensation at a rate of more than \$4800 per year;

(b) elect, appoint or otherwise engage or employ to or for any office or position, any person not shown in said Schedule A, to or for any office or position at a compensation at a rate of more than \$4800 per year;

without, in each case, obtaining the prior written consent of Reconstruction.

4. Nothing contained in this Agreement shall be deemed to prohibit the Railroad from effecting any reduction in compensation below the respective amounts set forth in said Schedules, for any of its officers, directors or employees, or, in the case of a vacancy in any of the offices or positions shown in said Schedules from filling such vacancy through

promotion, new employment or otherwise, at the rate of compensation for such office or position set forth in said Schedules, or as requiring or permitting the Railroad to violate any of the provisions of the Railway Labor Act, or other federal act or executive order relative to compensation as defined herein, or any existing or future agreements made with labor organizations or groups of employees acting collectively, or of any judgment or decree of a court.

5. If any company, directly or indirectly, controlling or affiliated with, or controlled by, the Railroad, shall increase the compensation paid by it to any officer, director or employee of the Railroad, and if, after such increase, the aggregate annual compensation paid to such officer, director or employee by every such other company and by the Railroad would be in excess of \$4800, the compensation payable by the Railroad to such officer, director or employee shall be reduced in an amount equal to the amount of such increase or the amount of such excess, whichever shall be the less. The Railroad shall give immediate written notice to Reconstruction of any such increase by any such Company of any such compensation paid or to be paid any officer, director or employee of the Railroad.

6. From time to time, upon request of Reconstruction, the Railroad shall furnish, in form attached, schedules of all the compensation currently paid to the officers, directors and employees of the Railroad.

7. This Agreement shall be binding upon the successors and assigns of the Railroad, and shall enure to the benefit of any department, branch, or agency of the Government which may be successor to or assign of Reconstruction.

Respectfully submitted,

THE WESTERN PACIFIC
RAILROAD COMPANY.

By.....
President.

Attest: .

.....
Secretary.

EXHIBIT "F"

The Western Pacific Railroad Company

Instructions to Guaranty Trust Company of New
York, as Depositary and Exchange Agent

New York, N. Y.

December . . . , 1944

Guaranty Trust Company of New York

140 Broadway

New York 15, N. Y.

Gentlemen:

The designation of Guaranty Trust Company of New York as Depositary and Exchange Agent under the Plan of Reorganization of The Western Pacific Railroad Company (hereinafter called the Railroad Company), confirmed October 11, 1943, has been approved by the District Court of the

United States for the Northern District of California, Southern Division, by Order entered October 23, 1944, in the proceedings now pending in said Court for the reorganization of the Railroad Company, and said Court has likewise approved the instructions given to you herein as such Depositary and Exchange Agent.

The maximum amount of securities to be issued under the Plan and delivered by you as Depositary and Exchange Agent are as follows:

First Mortgage 4% Bonds, Series

A, due January 1, 1974.....\$10,000,000

General Mortgage 4½% Income

Bonds, Series A, due January

1, 2014\$21,219,000

Preferred Stock, Series A (\$100

par value)\$31,850,200

Common Stock, no par value....319,032.767 shares

General Mortgage Income Bonds are not issuable in denominations of less than \$100 and fractional shares of stock will not be issued. These fractions are to be covered by Scrip, as hereinafter provided.

Cash payments are to be distributed with the securities to be delivered, as hereinafter provided.

The claimants entitled to receive securities and cash are (1) holders of the Railroad Company's present First Mortgage Bonds, being the Bonds issued under the Railroad Company's First Mortgage, dated the twenty-sixth day of June, 1916, due March 1, 1946, (2) Reconstruction Finance Cor-

poration, (3) The Railroad Credit Corporation, and (4) A. C. James Co.

The undersigned Reorganization Committee will, under the terms of the order of the District Court of, 1944, cause to be published a notice to security holders informing them that they are entitled to present to you the obligations of the Railroad Company now held by them, and to receive on and after December 29, 1944, in exchange therefor the new securities and cash to which they are entitled; in addition all known holders of First Mortgage Bonds due March 1, 1946, and other claimants mentioned above will be notified by circular or other letter giving the basis of exchange. Letters of transmittal and instructions to First Mortgage Bondholders for use in surrendering their bonds for exchange will also be sent to all known holders of such bonds and you will be furnished with an additional supply of such letters of transmittal and instructions. All First Mortgage Bonds surrendered to you should be accompanied by such letters of transmittal or by written instructions to effect the exchange thereof under the Plan of Reorganization. In case a letter of transmittal is signed by a responsible bank or broker in behalf of the owner, no evidence of authority to act as agent need be required by you. No special letters of transmittal have been prepared for claimants other than First Mortgage Bondholders

First Mortgage 5% Series A Bonds due March 1, 1946, are outstanding in the amount of \$49,290,100

including \$300 of Bond Scrip Certificates. These scrip certificates (aggregating \$300) shall be treated as Bonds for a like amount if surrendered to you, provided they are surrendered in principal amounts of \$100 or multiples thereof.

The denominations of outstanding First Mortgage Bonds in coupon form are \$100, \$500 and \$1,000. Except for one bond in the amount of \$350,000, in the denominations of outstanding First Mortgage Bonds in fully registered form are \$1,000 and \$10,000. First Mortgage Bonds in registered form surrendered to you as Depositary and Exchange Agent need not be endorsed or accompanied by instruments of transfer unless the new securities are to be registered in a name other than the name in which the surrendered bonds are registered or unless the checks for the adjustment payments to accompany such new securities are to be in names other than the name in which the surrendered bonds are registered. First Mortgage Bonds in coupon form should either have March 1, 1934, and subsequent coupons attached or should be accompanied by an affidavit and indemnity agreement (without surety) on your customary form for any missing coupons. In case coupons due prior to March 1, 1934, are attached to any bonds received by you by mail, you are to detach such coupons and return the same to the party on whose behalf the bonds are presented. Certain coupons due March 1, 1934, and subsequent bear a stamp regarding the deferment of the interest represented thereby, but it is imma-

terial whether such stamp is or is not on any coupons. In the event that one or more First Mortgage Bonds shall be mutilated, destroyed, lost or stolen, you, as Depositary and Exchange Agent, are authorized upon receipt of satisfactory evidence of such destruction, loss or theft, or upon the surrender of the bond or bonds, if mutilated, and upon receipt of indemnity satisfactory to you and to the Railroad Company (subject however to the approval of the Executive Committee or Board of Directors of the Railroad Company evidenced by a general or special resolution, a certified copy of which is to be furnished to you), to deliver new securities of such nature and amount and such cash as would have been deliverable against such bond or bonds in the absence of such mutilation, destruction, loss or theft.

Of said First Mortgage Bonds ten bonds, to wit: those numbered M-3595, M-3596, M-21612, M-21613, M-21614, M-21615, M-21616, M-21618, M-21619 and M-21620 are to be presented without coupons maturing prior to September 1, 1935, and in the delivery of securities each such bond is to receive a lesser amount of common stock than the generality of such bonds; and certain common stock, as hereinafter provided, is to be delivered to The Western Pacific Railroad Corporation, a Delaware Corporation, upon surrender of coupons numbered 36 and 37 with respect to said bonds.

Treatment of First Mortgage Bondholders

Upon receipt of First Mortgage Bonds due March 1, 1946, with coupons and/or indemnity agreement as aforesaid, you as Depositary and Exchange Agent are to deliver new securities and pay cash to the persons surrendering such bonds, at the rates indicated below. The securities to be delivered are as follows:

Principal Amount of Old First Mortgage Bonds Received	New Preferred Stock of \$100 par Value per Share (or Scrip) to be Delivered
\$ 100.	3/5 shares
500.	3 shares
1,000.	6 shares
10,000.	60 shares

New General Mortgage Income Bonds (or Scrip) to be Delivered	New Common Stock (or Scrip) to be Delivered
\$ 40.	.467 shares
200.	2.335 shares
400.	4.67 shares
4,000.	46.7 shares

With the delivery of said securities, cash adjustment payments are to be made as follows:

(a) with each General Mortgage 4½% Income Bonds, Series A, a cash adjustment payment at the rate of \$22.50 for each \$100 of the principal amount thereof,

(b) with each share of Preferred Stock, Series A, a cash adjustment payment of \$15.81,

(c) with each share of Common Stock, a cash adjustment payment of \$9.00,

(d) with Scrip Certificates for General Mortgage 4½% Income Bonds, Series A, for Preferred Stock, and for Common Stock, proportionate cash adjustment payments based on the amount of the Scrip Certificates are to be made, that is to say, with each Scrip Certificate for General Mortgage Bonds, the amount of which Scrip Certificate is \$20, a payment of \$4.50; with each scrip certificate representing 1/5 of a share of preferred stock, a payment of \$3.16; and with each Scrip Certificate representing a fractional amount of Common Stock, a payment of a proportionate part of \$9.

The new securities to be delivered to the First Mortgage Bondholders are in settlement for their claims with respect to principal and accrued and unpaid interest to January 1, 1939. With respect to each of the aforesaid ten bonds numbered M-3595, M-3596, M-21612, M-21613, M-21614, M-21615, M-21616, M-21618, M-21619 and M-21620, the amount of Common Stock to be delivered shall be 3.356 shares instead of 4.67 shares as indicated in the foregoing schedule. Against delivery of coupons numbered 36 and 37 appurtenant to said bonds, there shall be issued and delivered to or upon the order of The Western Pacific Railroad Corporation,

a Delaware corporation, for each such coupon .437 shares of Common Stock and the cash adjustment payment with respect thereto shall be paid to said corporation or upon its order.

The adjustment payments in cash to be made as indicated above are based upon an order of the District Court of the United States for the Northern District of California, Southern Division, entered September 25, 1944, which determined the available net income of the Railroad Company for the calendar years 1939-1943, inclusive, and the allocation of such available net income, including the said adjustment payments to be made to security holders at the time of the consummation of the plan of reorganization. Such adjustment payments are, as to the General Mortgage Income Bonds at the rate of $22\frac{1}{2}\%$ of the principal amount thereof; as to the new Preferred Stock at the rate of \$15.81 per share and as to the new Common Stock at the rate of \$9 per share. These adjustment payments are not made as either interest or dividends. The General Mortgage Income Bonds will draw interest from January 1, 1944, and the shares of stock to be delivered will not be entitled to dividends for any period prior to January 1, 1944.

First Mortgage Bonds of 1946, presented to you for exchange for the new securities and adjustment payments, are to be cancelled and cremated by you.

Treatment of Claim of Reconstruction Finance Corporation

Upon

(1) receipt from Reconstruction Finance Corporation of the following certificates of indebtedness issued by the Trustees:

Certificates numbered 1 to 10 both inclusive, in bearer form, dated the first day of December, 1938, originally payable December 1, 1939, bearing interest at the original rate of 3% per annum, each in the original principal amount of \$1,000,000, said certificates being signed in the name of T. M. Schumacher and Sidney M. Ehrman, as Trustees, by M. J. Curry, Asst. Treasurer and countersigned by the Deputy Clerk of the District Court of the United States for the Northern District of California, Southern Division;

(2) the payment by Reconstruction Finance Corporation of \$6,000,000 (being the cash collateral heretofore deposited as security for said Certificates);

(3) the surrender of the following notes of the Railroad Company aggregating \$2,963,000 in principal amount, held by Reconstruction Finance Corporation:

Note dated March 1, 1932,

due March 1, 1935.....\$ 699,000

Note dated June 29, 1932, due June 29, 1935.....	734,584
Note dated August 1, 1932, due August 1, 1935.....	136,045
Note dated August 30, 1932, due August 30, 1935.....	1,293,440
Note dated March 25, 1933, due March 25, 1936.....	99,931

(4) the surrender of the following bonds of the Railroad Company aggregating \$10,750,000 in principal amount held by Reconstruction Finance Corporation as collateral for said notes:

General and Refunding Mortgage Bonds Series A issued by the Railroad Company in temporary form dated the 1st day of January, 1932, No. T-2, for the principal amount of \$8,750,000.

General and Refunding Mortgage Bond Series B issued by the Railroad Company in temporary form, dated the 1st day of July, 1932, No. T-1, for the principal amount of \$2,000,000 and

(5) the payment by Reconstruction Finance Corporation of \$..... (being the sum of \$1,075,000, less \$..... interest upon said 'Trustees' Certificates to December 29, 1944, and less \$....., being an amount equal to interest on \$10,000,000 of the new First Mortgage 4% Bonds from December 29, 1944, to January 1, 1945),

you are to deliver to Reconstruction Finance Corporation:

\$10,000,000 principal amount of the new First Mortgage Bonds, in temporary registered form, in one piece bearing interest from January 1, 1945,

\$ 1,185,200 principal amount of the new General Mortgage 4½% Income Bonds, Series A, in temporary form, in the following denominations, to wit:

118 bonds of the denomination of
\$10,000

1 bond of the denomination of
\$5,000, and

2 bonds of the denomination of
\$100.

17,778 shares of the new Preferred Stock, in temporary form, in the following denominations, to wit:

177 certificates for 100 shares, and
1 certificate for 78 shares.

15,788 shares of the new Common Stock in temporary form in the following denominations, to wit:

157 certificates for 100 shares, and
1 certificate for 88 shares,

and you are to pay to Reconstruction Finance Corporation \$689,832.18 in cash, being the aggregate of (a) \$266,670, the cash distribution with respect to the General Mortgage Bonds so delivered, (b)

\$281,070.18, the cash distribution with respect to the Preferred Stock so delivered and (c) \$142,092, the cash distribution with respect to the Common Stock to be delivered.

Treatment of Claim of The Railroad Credit Corporation

Upon

(1) surrender to you of the following notes of the Railroad Company held by The Railroad Credit Corporation:

Note dated June 29, 1932, due February 28, 1934, for the principal sum of\$1,303,000

Note dated March 25, 1933, due March 24, 1935, for the principal sum of\$1,293,439

and (2) the surrender of the following bonds of the Railroad Company held as security for said notes:

General and Refunding Mortgage Bond, Series A, No. T-5, dated the first day of January, 1932; in the principal amount of \$2,000,000,

General and Refunding Mortgage Bond, Series B, No. T-2, dated the first day of July, 1932, in the principal amount of \$2,000,000,

you are to deliver to The Railroad Credit Corporation the following:

\$154,080 principal amount of the new General Mortgage 4½% Income Bonds, Series A, in temporary form, in the following denominations, to wit:

15 Bonds of the denomination of \$10,000 each

4 Bonds of the denomination of \$1,000 each

Scrip certificates representing said bonds in the amount of \$80.

2,416.4 shares of the new Preferred Stock, in temporary form in the following denominations:

24 Certificates for 100 shares each

1 Certificate for 16 shares

Scrip Certificates for 2/5 of a share of the new Preferred Stock,

not more than 35,425 shares of Common Stock (or scrip certificates for fractional shares) the amount of such shares so to be distributed to be reduced by one (1) share for each \$62 of the amounts to which the debtor and its subsidiaries became entitled under the marshalling and distributing plan of 1931, insofar as such amounts were retained by The Railroad Credit Corporation and applied by it, after December 31, 1938, and prior to the distribution of such securities, to the obligations of the Railroad Company to The Railroad Credit Corporation.

Prior to December 29, 1944, you will be notified of the amount of such reduction. The balance of said 35,425 shares of Common Stock, together with the cash distribution with respect thereto shall be held until determination of the appeal of The Railroad Credit Corporation from the order of September 14, 1944, with respect to such reduction and if said appeal be successful shall be then distributed and paid over to The Railroad Credit Corporation; otherwise to be returned to the Railroad Company:

and you are to pay to The Railroad Credit Corporation a sum which shall be the aggregate of (a) \$34,668 being the cash distribution with respect to the General Mortgage Income Bonds so delivered; (b) \$38,203.28 being the cash distribution with respect to the Preferred Stock so delivered; (c) a sum which shall be at the rate of \$9 a share on the Common Stock and scrip certificates therefor so delivered; and (d) \$72.

Treatment of Claim of A. C. James Co.

Upon

(1) surrender to you of the following notes of the Railroad Company to A. C. James Co.

Note Dated March 28, 1932—\$4,851,000.00
Due March 28, 1935

Note Dated May 31, 1932—\$148,800.00 Due
May 31, 1935

and (2) the surrender of the following bonds of the Railroad Company held as security for said notes:

General and Refunding Mortgage Bond, Series A, No. T-3, in temporary form, dated January 1, 1932, in the principal amount of \$433,500.

General and Refunding Mortgage Bond, Series A, No. T-4, in temporary form in the principal amount of \$186,000.

General and Refunding Mortgage Bond, Series A, No. T-6, in temporary form in the principal amount of \$3,630,000.

you are to deliver to A. C. James Co. or the holder of said notes:

\$163,680 principal amount of the new General Mortgage Bonds, in temporary form, in the following denominations:

16 Bonds of the denomination of...	\$10,000
3 Bonds of the denomination of...	1,000
1 Bond of the denomination of...	500
1 Bond of the denomination of...	100
Scrip certificates representing said bonds in the amount of...	80

2,567 shares of the new Preferred Stock, in temporary form, in the following denominations:

25 Certificates for 100 shares each
1 Certificate for 67 shares

37,635 shares of the new Common Stock, in temporary form, in the following denominations:

376 Certificates for 100 shares each

1 Certificate for 35 shares

and you are to pay to the holder of said notes the sum of \$416,227.27, being the aggregate of (1) \$36,828, the cash distribution with respect to the General Mortgage Bonds so delivered, (2) \$40,584.27 the cash distribution with respect to the Preferred Stock so delivered, (3) \$338,715, the cash distribution with respect to the Common Stock so delivered and (4) the sum of \$100.

Of the collateral for the notes of Reconstruction Finance Corporation, The Railroad Credit Corporation and the A. C. James Co., all bonds of the debtor are to be cancelled and cremated by you and the other obligations returned to the Railroad Company.

Crocker First National Bank of San Francisco, California, is Corporate Trustee of the new First Mortgage Bonds and it has been instructed to authenticate and deliver to you the \$10,000,000 of Series A Bonds of that issue which you are to deliver to the Reconstruction Finance Corporation.

The Chase National Bank of the City of New York is Corporate Trustee of the new General Mortgage Income Bonds and it has been instructed to honor your requisitions for General Mortgage 4½% Income Bonds, Series A, to be delivered by you as set out above.

All new General Mortgage Income Bonds so requested by you will be dated January 1, 1939. The denominations are \$100., \$500., \$1,000., \$5,000. and \$10,000. Scrip in lieu of fractional amounts of new General Mortgage Income Bonds needed by you for exchange are to be obtained by you from the Scrip Agent as hereinafter provided.

Central Hanover Bank and Trust Company is Transfer Agent for the new Preferred and Common Stocks and it has been instructed to honor your requisitions for not exceeding 318,502 shares of new Preferred Stock and 319,032 shares of new Common Stock. Both new Common and new Preferred Stock Certificates are issuable in denominations of 100 shares and less than 100 shares. Only full shares of stock are to be requisitioned from Central Hanover Bank and Trust Company. Scrip in lieu of fractional shares are to be requisitioned from the Scrip Agent in accordance with the succeeding paragraph.

City Bank Farmers Trust Company is Scrip Agent for scrip certificates to be issued in respect to the General Mortgage Income Bonds and Preferred and Common Stocks. Bond scrip is issuable in the denomination of \$20., Preferred Stock scrip in the denomination of one-fifth of a share, and Common Stock scrip will be in fractional denominations of which the denominator in each case is 1,000. The Scrip Agent has been authorized to honor your requisitions for scrip of all three classes required by you in connection with exchanges. The Corporate Trustee of the General Mortgage Income Bonds has

been instructed to reserve for account of the Scrip Agent sufficient bonds to cover outstanding scrip in accordance with the requirements of the Scrip Agreement between the Company and City Bank Farmers Trust Company dated December 28, 1944, upon notice of issuance of scrip by the Scrip Agent. Similarly the Transfer Agent of the new Preferred and new Common Stock has been instructed to reserve sufficient stock for account of the Scrip Agent in respect to outstanding Preferred and Common scrip, upon notice of issuance of such scrip. The Scrip Agreement provides that all classes of scrip issued thereunder become void on and after January 1, 1950, and permits the sale of the Bonds and Stock reserved for the scrip after January 1, 1948. In the event of redemption or sale of Bonds or Stock reserved for scrip, the scrip certificates are entitled to their pro rata share of the net proceeds including accrued interest and dividends. When any of these events occur it will no longer be possible to issue scrip certificates and at that time the undersigned Railroad Company will provide you with supplemental instructions as to procedure and an amount of cash estimated to be necessary to be paid to the old security holders in lieu of scrip.

Upon or prior to the opening of business on December 29, 1944, you will be put in funds for the account of The Western Pacific Railroad Company to cover the adjustment payments in cash to be made in connection with the issue of the new securities as set out above. Separate checks are to be

given for such adjustment payments with respect to Bonds, Preferred Stock and Common Stock respectively. At the date fixed for the consummation of the plan, i.e., December 29, 1944, there will be no interest or dividends payable on the new Bonds and Stocks requisitioned by you. In the case of subsequent presentations of existing securities for exchange, the Corporate Trustee of the new General Mortgage Income Bonds and the Transfer Agent, for the new Common and Preferred Stocks have been instructed to send you, along with any such new Bonds and Stock requisitioned by you, checks for such interest and dividends as may hereafter be paid upon such securities, such checks to be drawn to the order of the holders indicated on your requisitions. Such checks should be delivered by you to the respective holders along with the new securities.

Prior to the commencement of the exchange we will furnish you with an opinion of our counsel as to whether or not withholding tax is required to be deducted by you on payment of the cash distribution to non-resident alien holders and such opinion will also cover the basis of transfer tax where the new securities are to be issued in a name other than that of the owner of the securities deposited.

The notes received by you from the Reconstruction Finance Corporation, The Railroad Credit Corporation and A. C. James Company should be fully cancelled by you and returned to the Railroad Company.

There will be delivered to you prior to commencement of exchange the following documents:

1. Certified copy of Resolution or other document of the Reorganization Committee designating you as Depositary and Exchange Agent;

2. Certified copy of Resolution adopted by the Board of Directors of the Railroad Company authorizing execution of this letter agreement;

3. Certified copy of Order or Orders of the Federal Court approving your appointment, and approving these instructions and generally authorizing the consummation of the reorganization;

4. Copy of published notice over the signature of the Reorganization Managers relative to the commencement of exchange;

5. Supply of letters of transmittal and instructions to First Mortgage Bondholders and circular letters to such Bondholders regarding the basis of the exchange;

6. Copies of instructions given by the Railroad Company to the Corporate Trustee of the new General Mortgage Income Bonds, the Transfer Agent of the new Preferred and Common Stock and the Scrip Agent with respect to delivery of securities and future interest and dividends upon your requisition;

7. Letters from the General Mortgage Corporate Trustee and Transfer Agent and Scrip Agent of the new securities that they are prepared to honor your requisitions for the amount of new securities required for the exchange;

8. Specimens of old First Mortgage Bonds and all new securities; copies of new Mortgages and Scrip Agreement;

9. List of stop payment orders on old First Mortgage Bonds.

It is understood that these instructions may from time to time be supplemented or amended by additional instructions in writing, either upon your request to the undersigned or upon the initiative of the Reorganization Committee or the Railroad Company. Such instructions may be given either by the Reorganization Committee or by the President or Vice President, Secretary or Treasurer of the Railroad Company or by the Railroad Company and the Reorganization Committee jointly. If given by the Reorganization Committee such instructions will be signed by their Chairman or by any two members.

As Depositary and Exchange Agent you may advise with counsel for either of the undersigned or your own counsel in any matter arising in connection with the Depositary and Exchange Agency, and you shall be fully protected in relying upon the advice of such counsel.

It is understood and agreed that you are not to

be in any way responsible for the form or validity of any security delivered by you hereunder, and that you shall be fully protected in accepting any security, endorsement, assignment, instruction or other paper or document believed by you to be valid or genuine, and to have been signed by or on behalf of the proper person or persons. The undersigned Railroad Company agrees to indemnify and hold you harmless from and against any and all claims or liabilities asserted against you by reason of any action or actions taken by you pursuant to the instructions herein contained. Without limiting the foregoing indemnity provisions, it is hereby agreed that the same apply to and cover liability for taxes and other governmental charges which you may at any time incur by reason of the receipt or delivery of securities in connection with effecting exchanges hereunder or the receipt or the holding of payment of any cash in connection with your duties hereunder.

At any time after January 1, 1955, the Railroad Company may request you to terminate your duties as Depositary and Exchange Agent, and after the date fixed by the Railroad Company for such termination, you shall pay and deliver to the Railroad Company any cash and securities held by you as Depositary and Exchange Agent. Thereafter all exchanges of securities under the Plan of Reorganization shall be made by the Railroad Company in the discretion and under such conditions as may be prescribed by its Board of Directors or Executive

Committee. Until such time as your duties as Depository and Exchange Agent are terminated, all cash and any securities which may be held by or reserved for you for distribution under the Plan of Reorganization shall be held in trust for the purposes herein expressed.

Yours very truly,

.....
.....

Reorganization Committee
THE WESTERN PACIFIC
RAILROAD COMPANY,

By
(Vice) President

Attest:

.....
Assistant Secretary.

We agree to act in accordance with the foregoing letter agreement, a counterpart of which has been received and retained by us.

GUARANTY TRUST COMPANY
OF NEW YORK, as Depository
and Exchange Agent

By
Trust Officer.

Dated:

I hereby certify that the annexed instrument is a true and correct copy of the original on file in my office.

Attest:

C. W. CALBREATH

Clerk, District Court of the
U. S., Northern District of
California.

[Seal] By A. T. ALLEN
Deputy Clerk.

EXHIBIT No. 2

In the District Court of the United States for the
Northern District of California, Southern Division.

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD COMPANY,
PANY,

Debtor.

FINAL ORDER

The petition filed March 18, 1946, by Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, the duly constituted Reorganization Committee designated to carry out the plan of reorganization of The Western Pacific Railroad Company above-named, for an order approving their expenses, dis-

charging the Committee and terminating the proceedings duly came on to be heard on March 28, 1946, and was heard and has been submitted.

The Court being fully advised in the premises finds that notice of the hearing upon said petition has been given as prescribed by the order of this Court dated and filed March 18, 1946, and that all of the allegations and representations contained in the petition are true. The Court further finds and concludes:

(a) All of the business, assets and property constituting the debtor's estate of every kind and character, real, personal and mixed, and all of the right title and interest therein of T. M. Schumacher and Sidney M. Ehrman, as Trustees in Reorganization, vested in and became the absolute property of The Western Pacific Railroad Company on December 29, 1944, free and clear of all rights, claims, interests, liens and encumbrances of the former stockholders and creditors of the debtor company and all other persons, except as otherwise provided and directed in the order of this Court in this proceeding dated and entered November 27, 1944; and The Western Pacific Railroad Company is released and discharged forever from all of its debts and liabilities existing on or before December 28, 1944, whether or not the same have been presented and allowed in these proceedings, and said reorganized Company is free and clear of all such rights claims, interests, liens, encumbrances, debts, obligations and liabilities, except as otherwise expressly provided in said order.

(b) The plan of reorganization of The Western Pacific Railroad Company, which was duly confirmed by order of this Court dated and entered October 11, 1943, has been fully and properly carried out and put into effect in accordance with the terms and provisions of said plan and the orders of this Court heretofore entered in this proceeding; all acts and things required by the order of this Court dated and entered November 27, 1944, to be done or performed in order to consummate said plan, have been properly done or performed; the exchange of more than 99% of the principle amount of securities of the reorganized company has been effected in accordance with the plan of reorganization and the orders of this Court; and adequate and proper arrangements have been made for the exchange of the remainder of said securities.

(c) The reasonable and necessary expenses of the Reorganization Committee in carrying out and putting into effect the plan of reorganization, as disclosed by Schedule "B" annexed to the petition for this order, filed by said Committee and supported by evidence introduced at the hearing upon said petition, exclusive of the fees and expenses of the attorneys for said Committee, which have heretofore been approved and allowed by order of this Court filed December 10, 1945, are within the maximum limits approved by the Interstate Commerce Commission and authorized by this Court by order filed October 23, 1944, and should be finally approved and allowed.

(d) Frederick H. Ecker, Frank C. Wright and

Robert E. Coulson, members of the duly constituted Reorganization Committee, have fulfilled their functions, faithfully performed their duties as members of the Reorganization Committee and now have no further duties and should be discharged.

(e) The plan of reorganization having been carried out and put into effect in accordance with the terms of the plan and the orders of this Court, a final decree should be entered in this cause, subject only to the reservations of the jurisdiction hereinafter made in this decree.

Now, Therefore, it is hereby Ordered, Adjudged and Decreed:

1. That these proceedings be and they hereby are terminated subject only to the reservations of jurisdiction hereinafter made by the Court in this order, and the reservations of jurisdiction contained in the order of this Court discharging the Trustees of the Debtor's estate, dated and entered May 21, 1945.

2. That the expenses incurred by the Reorganization Committee in consummating, carrying out and putting into effect the plan of reorganization, as shown by the summary which is attached as Exhibit "B" to the petition for this order, filed by the Reorganization Committee, are hereby in all respects finally approved and allowed.

3. That the actions of the Reorganization Committee in putting into effect and carrying out the plan of reorganization and the orders and directions

of this Court relative thereto, are hereby approved, ratified and confirmed.

4. That Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, the members of the Reorganization Committee herein, be and each of them is hereby discharged and relieved from all further duties herein.

5. That the order of this Court dated and entered November 27, 1944, in this proceeding shall remain in full force and effect in so far as said order has not been fully carried out.

6. All persons, firms, and corporations whatsoever, and wheresoever situated, located or domiciled, are hereby perpetually restrained and enjoined from instituting, prosecuting, or pursuing, or attempting to institute, prosecute or pursue, any suit or suits or proceedings in law or in equity, or otherwise, against The Western Pacific Railroad Company, or against the successors or assigns of said company, or against any of the assets or property of said Company or its successors or assigns, directly or indirectly, on account of or based upon any right, claims or interest of any kind or nature whatsoever which any such person, firm or corporation may have had in, to or against the Debtor, or any of its assets or properties, on or before December 28, 1944 (except as specifically provided for or permitted by prior order of this Court), and from interfering with, attaching, garnishing, levying upon, enforcing liens against or upon, or in any manner whatsoever disturbing any portion of the property, real, per-

sonal, or mixed, of any kind or character, now or hereafter belonging to or being in the possession of said Company, and from interfering with or taking steps to interfere with said Company, its officers and agents, or the operation of the lines of railroad or properties or the conduct of the business of said Company, by reason or on account of any obligation or obligations incurred by the Debtor or by the Trustees of the Debtor's estate on or before December 28, 1944 (except as specifically provided for or permitted by prior order of this Court), and all such persons, firms and corporations are also hereby restrained and enjoined from prosecuting against the Reorganization Committee, or any of them, their agents or attorneys, or against the Trustees of the Debtor's estate, or either of them, their agents or attorneys, or against the said Company, its agents or attorneys, any suit or proceeding arising out of, or based on, any act or acts done or omitted to be done in putting into effect and carrying out the plan of reorganization or any order of this Court entered in these proceedings.

7. The Western Pacific Railroad Company is hereby ordered and directed to reimburse, indemnify and hold harmless the members of the Reorganization Committee, or any of them, or any person employed by them, against any loss or expense arising out of or in connection with carrying out and putting into effect in good faith the plan of reorganization, including, without limitation of the generality of the foregoing, the contingent tax liability described in the order of the Interstate Com-

merce Commission of September 7, 1944, and allowed in the order of this Court entered October 23, 1944.

8. The Western Pacific Railroad Company is hereby directed to give notice of the entry of this final order by mailing, postage prepaid, a copy of this order to the Trustees of the Debtor's estate, the Reorganization Committee, each party of record in the reorganization proceedings before this Court or the Interstate Commerce Commission (or the counsel for each such party), and to cause promptly to be published a notice of the entry of this final order, setting forth in said notice the complete text of this order as certified by the clerk of this Court, such publication to be made once in each of the following: A daily newspaper of general circulation in the City of San Francisco, California; a daily newspaper of general circulation in the City of New York, New York; and a daily newspaper of general circulation in the City of Chicago, Illinois. Proof of such service and publication shall be filed by said Company with the Clerk of this Court within thirty days after the completion of the same.

9. The Court hereby reserves jurisdiction to take such further proceedings as may be proper or necessary to enforce and make effective any direction or other provision contained in the order of this Court, filed November 27, 1944, in this proceeding, to enforce and make effective the terms and provisions of this final decree and, if necessary, to give instructions to The Western Pacific Railroad Company, upon application by said Company, with respect to

carrying out the provisions of said order filed November 27, 1944, and of this order; to take such further proceedings as may be proper or necessary in connection with any appeal or appeals prosecuted from any order of this Court, in this proceeding; and to take such further proceedings as may be necessary or proper in connection with any expenses or liabilities within the provisions of the order of this Court filed October 23, 1944, or otherwise, which may hereafter be asserted against the Reorganization Committee, its agents or attorneys, in connection with carrying out and putting into effect the plan of reorganization.

10. Except as hereby specifically provided in the reservations of jurisdiction set forth in Paragraph 9 above, and except as provided in the reservations of jurisdiction of the order of this Court filed May 21, 1945, discharging the Trustees of the Debtor's estate, the reorganization proceedings in this Court, entitled in the Matter of the Western Pacific Railroad Company, Debtor, No. 26591-S, are hereby terminated and the case is closed.

Dated: March 28, 1946.

A. F. St. SURE,
District Judge.

[Endorsed]: Filed Mar. 28, 1946.

EXHIBIT No. 3

In the District Court of the United States, for the Northern District of California, Southern Division.

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD COMPANY,

Debtor.

ORDER AUTHORIZING ESTABLISHMENT
OF A RESERVE FUND FOR CONTINGENT TAX LIABILITIES

The petition filed February 21, 1944, by T. M. Schumacher and Sidney M. Ehrman, the Trustees of the properties of the Debtor above-named, for authority to establish a reserve fund of \$7,100,000 for contingent tax liabilities, came on duly to be heard and was heard this day and thereupon submitted. Good cause appearing therefore, the Court being fully advised, finds that notice of the hearing upon said petition has been given as prescribed by the order of this Court, that all of the averments of said petition are true, and that it is for the best interests of the estate of the Debtor that this order be made.

Now, Therefore, It Is Hereby Ordered, Adjudged and Decreed that the Trustees are hereby authorized to establish, with funds in their hands belonging to

the estate of the Debtor and derived from the earnings of the railroad of the Debtor during the year 1943, a reserve fund in the amount of \$7,100,000, to be designated as the "Reserve Fund for Contingent Tax Liabilities," to be invested in United States Treasury securities, and to be used for the payment of any Federal income and excess profits taxes which may be found due for the year 1943.

Dated: March 3, 1944.

A. F. St. SURE,
Judge.

[Title of District Court and Cause.]

ANSWER OF DEFENDANT
THE WESTERN REALTY COMPANY

Comes now the defendant The Western Realty Company, and answering the complaint of plaintiff herein, respectfully shows and alleges:

I.

Denies each and every allegation contained in paragraphs I and II of the complaint, except that said defendant admits that it is a Colorado corporation, that the plaintiff, The Western Pacific Railroad Corporation, is a Delaware corporation, that the defendants The Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway Company, Delta Finance Co., Ltd., and Standard Realty and Development

Company are California corporations, and that Deep Creek Railroad Company was formerly a Utah corporation and was dissolved prior to the commencement of this action.

II.

Denies each and every allegation contained in paragraph III of the complaint, except that said defendant admits that this is a civil action between citizens of different states and that the amount in controversy exceeds the sum of \$5,000, exclusive of interest and costs.

III.

Denies each and every allegation contained in paragraph IV of the complaint, except that said defendant admits that, during the years 1942 and 1943 and the first four calendar months of the year 1944, the plaintiff and the above-named defendant corporations constituted an affiliated group of corporations within the meaning of the Internal Revenue Code and income and excess profits tax returns for said years were filed on a consolidated basis by the plaintiff on behalf of said affiliated group of corporations, that the consolidated returns for the year 1942 reported income and excess profits tax in the amount of \$4,201,821.54, the whole of which sum was paid in 1943 with funds supplied by the Reorganization Trustees of the defendant The Western Pacific Railroad Company, that the consolidated returns for the year 1943 and the first

four months of 1944 reported no taxable income, and that the plaintiff filed in 1945 a claim for refund of said sum of \$4,201,821.54 theretofore paid as income and excess profits tax for the year 1942, together with interest thereon.

IV.

Denies each and every allegation contained in paragraphs V, VI and VII of the complaint.

V.

The complaint fails to state a claim against the defendant The Western Realty Company upon which relief can be granted.

Wherefore, the defendant The Western Realty Company demands judgment that the complaint of the plaintiff herein be dismissed as to said defendant, together with the costs and disbursements of this action.

PILLSBURY, MADISON &
SUTRO,

/s/ FELIX T. SMITH,

/s/ EVERETT A. MATHEWS,

WHITMAN, RANSOM,

COULSON & GOETZ,

Attorneys for defendant The
Western Realty Company.

[Endorsed]: Filed Dec. 30, 1946.

[Title of District Court and Cause.]

REPLY TO COUNTERCLAIM OF DEFENDANTS, THE WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY COMPANY, DELTA FINANCE CO., LTD., AND STANDARD REALTY AND DEVELOPMENT COMPANY

Now comes the Plaintiff and for its Reply to the Counter-claim of the answering Defendants the Plaintiff denies all of the allegations thereof, being paragraphs of the Counterclaim numbered I, II, III, IV and V, to the extent that such allegations are inconsistent with the Plaintiff's Bill of Complaint, and denies categorically the allegations of paragraph V that the Plaintiff threatens to apply to its own use and benefit any sums of money refunded under its refund claim or any other funds to which the Bill of Complaint relates except in accordance with the decree and judgment of this Court as prayed in its Bill of Complaint.

Wherefore, plaintiff prays that said counterclaim be dismissed, and for such other and further relief as may be proper.

Dated: March 4, 1947.

THE WESTERN PACIFIC
RAILROAD CORPORATION,
Plaintiff,

By /s/ LEROY R. GOODRICH,
Its Attorney.

Of Counsel:

FRANK G. NICODEMUS, JR.,
A. PERRY OSBORN.

[Endorsed]: Filed March 5, 1947.

In the District Court of the United States for the
Northern District of California, Southern Division

No. 26508-G

THE WESTERN PACIFIC RAILROAD COR-
PORATION,

Plaintiff,

vs.

THE WESTERN PACIFIC RAILROAD COM-
PANY, SACRAMENTO NORTHERN RAIL-
WAY, TIDEWATER SOUTHERN RAIL-
WAY, DEEP CREEK RAILROAD
COMPANY, THE WESTERN REALTY
COMPANY, THE STANDARD REALTY
AND DEVELOPMENT COMPANY and
DELTA FINANCE CO., LTD.,

Defendants.

* * *

In the Matter of:

THE WESTERN PACIFIC RAILROAD COM-
PANY,

Debtor.

* * *

RUSSELL M. VAN KIRK, HENRY OFFER-
MAN and J. S. FARLEE & CO., INC., a
Corporation,

Applicants for Intervention.

ORDER GRANTING LEAVE TO INTERVENE

Good Cause Appearing Therefor, it is hereby Ordered that Russell M. Van Kirk, Henry Offerman and J. S. Farlee & Co., Inc., a corporation, be and they are hereby granted leave to intervene as plaintiffs in the above-entitled action and to file herein their Complaint in Intervention which accompanies and is annexed to their Notice of Motion for Leave to Intervene dated March 11, 1947.

Done in Open Court this 7th day of April, 1947.

/s/ LOUIS E. GOODMAN,
U. S. District Judge.

[Endorsed]: Filed April 7, 1947.

In the District Court of the United States for the
Northern District of California, Southern Division
No. 26508-G

THE WESTERN PACIFIC RAILROAD COR-
PORATION,

Plaintiff,

vs.

THE WESTERN PACIFIC RAILROAD COM-
PANY, SACRAMENTO NORTHERN RAIL-
WAY, TIDEWATER SOUTHERN RAIL-
WAY, DEEP CREEK RAILROAD
COMPANY, THE WESTERN REALTY
COMPANY, THE STANDARD REALTY
AND DEVELOPMENT COMPANY and
DELTA FINANCE CO., LTD.,

Defendants.

RUSSELL M. VAN KIRK, HENRY OFFER-
MAN and J. S. FARLEE & CO., INC., a Cor-
poration,

Plaintiffs in Intervention,

vs.

THE WESTERN PACIFIC RAILROAD COM-
PANY, SACRAMENTO NORTHERN
RAILWAY, TIDEWATER SOUTHERN
RAILWAY, DEEP CREEK RAILROAD
COMPANY, THE WESTERN REALTY
COMPANY, THE STANDARD REALTY
AND DEVELOPMENT COMPANY, DELTA
FINANCE CO., LTD., and THE WESTERN
PACIFIC CORPORATION,

Defendants in Intervention.

* * *

In the Matter of:

THE WESTERN PACIFIC RAILROAD COM-
PANY,

Debtor.

COMPLAINT IN INTERVENTION

Come now the above named plaintiffs in interven-
tion, after leave of court first had and obtained, and
complaining of defendants in intervention in the
right of The Western Pacific Railroad Corporation
and on behalf of themselves and all other stockhold-
ers of said corporation similarly situated, file this,
their complaint in intervention, and allege as fol-
lows, to wit:

I.

Plaintiffs in intervention, Russell M. Van Kirk and Henry Offerman, are each a citizen of the State of New Jersey and plaintiff in intervention, J. S. Farlee & Co., Inc., is a corporation duly organized and existing under and by virtue of the laws of the State of New York.

II.

Defendant in intervention, The Western Pacific Railroad Corporation (hereinafter referred to as the "Corporation"), in behalf of which plaintiffs in intervention have intervened in this action, is a corporation duly organized and existing under and by virtue of the laws of the State of Delaware, and each and all of the remaining defendants in intervention are corporations duly organized and existing under and by virtue of the laws of the State of California, except that defendants in intervention, The Western Realty Company and Deep Creek Railroad Company, are corporations duly organized and existing under and by virtue of the laws of the States of Colorado and Utah, respectively. Defendant in Intervention, The Western Pacific Railroad Company, is hereinafter referred to as the "Railroad Company."

III.

(a) This is a civil action between citizens of different states and the matter in controversy exceeds, exclusive of interest and costs, the sum of \$3,000.00; that this action in intervention is not a

collusive one to confer upon this court jurisdiction of an action of which it would not otherwise have jurisdiction.

(b) From on or about August 2, 1935, to on or about March 28, 1946, the defendant in intervention, "Railroad Company," was in reorganization under Section 77 of the National Bankruptcy Act in that certain proceeding entitled "In the Matter of The Western Pacific Railroad Company, Debtor," No. 26591-S in the above-entitled court, the final order terminating said reorganization proceedings having been made and entered therein on March 28, 1946; that from on or about September 23, 1935, until on or about December 29, 1944, all the properties of said "Railroad Company" were held by the Reorganization Trustees appointed in said proceedings, and on or about December 29, 1944, pursuant to prior order of court the said Reorganization Trustees returned all its business, assets and properties to said reorganized "Railroad Company" and said defendant in intervention, to wit, said "Railroad Company," thereupon assumed all the obligations and liabilities of said Reorganization Trustees incurred by them in connection with said properties and proceedings and which had not been barred by said reorganization proceedings; that to the extent that the present action may involve any of such obligations or liabilities of said Reorganization Trustees so assumed by said defendant in intervention, "Railroad Company," or any funds or properties so transferred to said defendant in intervention by said Reorganization Trustees, it is an ac-

tion which is permitted by the reservations of jurisdiction in said reorganization proceedings and said order dated March 28, 1946.

IV.

Plaintiff in intervention, Russell M. Van Kirk, is the holder of 11,468 shares of the preferred stock of defendant in intervention, The Western Pacific Railroad Corporation, viz, the "Corporation," and has been a stockholder of said corporation at all times since August 13, 1942; that plaintiff in intervention Henry Offerman is the holder of 3,903 shares of the preferred stock of said defendant in intervention "Corporation" and has been a stockholder of said corporation at all times since July 7, 1942; that plaintiff in intervention, J. S. Farlee & Co., Inc., is the holder of 9,247 shares of the preferred stock of said defendant in intervention, "Corporation," and has been a stockholder of said corporation at all times since January 28, 1944; that plaintiffs in intervention, and each of them, were shareholders of said defendant in intervention, "Corporation," at the time of the transactions of which they complain herein.

V.

(a) Plaintiffs in intervention are informed and believe and therefore allege the fact to be that at all the times herein mentioned the defendants in intervention, Sacramento Northern Railway, Tidewater Southern Railway, Deep Creek Railroad Company, The Standard Realty and Development Company and Delta Finance Co., Ltd., and each of

them, were, and now are, wholly owned subsidiaries of defendant in intervention, The Western Pacific Railroad Company, viz, the "Railroad Company." Said defendants in intervention are hereinafter referred to as the "Railroad Group."

(b) From approximately the year 1916 to on or about April 30, 1944, the defendant in intervention, "Corporation," was the owner and holder of all the outstanding stock of defendant in intervention, "Railroad Company"; that during said period of time the said "Corporation" was a holding company, the principal assets of which consisted of all the outstanding stock of said "Railroad Company," as aforesaid, and all the stock of defendant in intervention, The Western Realty Company, as well as stock of the Denver & Rio Grande Railroad Co., a corporation; that during said time, until approximately the year 1941, the defendant in intervention, "Corporation," was primarily engaged in controlling and providing financing by loans and otherwise to said defendant in intervention, "Railroad Company," and the latter's aforementioned subsidiaries, to wit, the defendants in intervention, "Railroad Group."

(c) From on or about August 2, 1935, to on or about March 28, 1946, the defendant in intervention, "Railroad Company," was in reorganization under Section 77 of the National Bankruptcy Act in that certain proceeding entitled, "In the Matter of The Western Pacific Railroad Company, Debtor," No. 26591-S in the above-entitled court, as aforesaid; that said defendant in intervention,

“Railroad Company,” was reorganized in said proceedings under a plan of reorganization filed by the Interstate Commerce Commission on or about June 21, 1939, in which proposed plan of reorganization the capital stock of said Debtor, “Railroad Company,” so owned and held by the defendant in intervention, “Corporation,” as aforesaid, was found by the Interstate Commerce Commission to be worthless and without equity or value; that said proposed plan of reorganization was affirmed by the Supreme Court of the United States on or about March 11, 1943, and was finally confirmed by the court in said reorganization proceedings on or about October 11, 1943; that in and by said plan of reorganization as finally confirmed on or about October 11, 1943, as aforesaid, it was found and determined that the stock of said defendant in intervention, “Railroad Company,” so owned and held by defendant in intervention, “Corporation,” being all the stock of said “Railroad Company,” was wholly worthless and without equity or value; that pursuant to said finding an agreement was made and entered into on or about November 24, 1943, dated as of November 22, 1943, by and between the defendant in intervention, The Western Pacific Railroad Corporation, viz, the “Corporation,” the hereinafter mentioned James Foundation of New York, Inc., and Frederick H. Ecker, Frank C. Wright and Robert E. Coulson as the Reorganization Committee of defendant in intervention, The Western Pacific Railroad Company, viz, the “Railroad Company,” and certain other parties, wherein

and whereby it was provided, among other things, that said worthless stock of the "Railroad Company" so owned and held by the "Corporation," as aforesaid, should be assigned, transferred and delivered by the "Corporation" to the Reorganization Committee of the "Railroad Company" upon request by the latter for the purposes of said reorganization plan and for ultimate cancellation thereunder; that plaintiffs in intervention are informed and believe and therefore allege the fact to be that said stock was in fact so transferred on or about April 30, 1944; that on or about December 29, 1944, pursuant to prior order of the court in said reorganization proceedings, the Reorganization Trustees therein returned to said defendant in intervention, "Railroad Company," all its business, assets and property, as aforesaid, and thereupon said plan of reorganization was consummated; that the effective date of said plan of reorganization was January 1, 1939.

VI.

(a) As of December 31, 1946, the said defendant in intervention, The Western Pacific Railroad Corporation, viz, the "Corporation," had outstanding 381,205 shares 6% preferred stock and 574,457 shares of common stock; that plaintiffs in intervention are informed and believe and therefore allege the fact to be that all of said preferred and common stock of said "Corporation" is still outstanding; that each share of said common and preferred stock is entitled to one vote and upon liquida-

tion of the corporation the preferred stock is entitled to the payment of \$100 per share plus accumulated dividends; that no dividends have been paid on said preferred stock since approximately the year 1927.

(b) As hereinbefore alleged the stock holdings of the defendant in intervention, "Corporation," in said defendant in intervention, "Railroad Company," were found to be worthless and without equity or value by the Interstate Commerce Commission on or about June 21, 1939, in the aforesaid plan for the reorganization of said "Railroad Company," which plan of reorganization was finally confirmed by the court in said reorganization proceedings on or about October 11, 1943; that likewise the aforesaid stock holdings of defendant in intervention, "Corporation," in the Denver & Rio Grande Railroad Co. were found to be worthless by the Interstate Commerce Commission in proceedings for the reorganization of that company, which finding was approved by the Supreme Court of the United States; that pursuant to the aforementioned agreement dated as of November 22, 1943, by and between said "Corporation" and said James Foundation of New York, Inc., and said Reorganization Committee of said "Railroad Company" and others, the aforesaid stock holdings of defendant in intervention, "Corporation," in defendant in intervention, The Western Realty Company, were transferred to said "Foundation" in purported satisfaction of an indebtedness of said "Corporation" to said "Foundation"; that the remaining assets

of said defendant in intervention, "Corporation," were negligible, and its outstanding common stock, to wit, said 574,457 shares, has had no financial worth or value since approximately the year 1941; that presently the prior claims of said outstanding preferred stock, to wit, said 381,205 shares, are in excess of the sum of \$50,000,000.

(c) Plaintiffs in intervention are informed and believe and therefore allege the fact to be that since approximately the year 1941 the said defendant in intervention, "Corporation," has engaged in no business and has received only nominal income insufficient to cover its operating expenses; that no regular meetings of the stockholders of said "Corporation" have been held and no annual reports have been sent out to its stockholders by said "Corporation" since approximately said year 1941; that on or about April, 1943, the directors of said defendant in intervention, "Corporation," were in the process of liquidating said company; that on or about August 16, 1943, the securities of said "Corporation" were delisted from the New York Stock Exchange.

VII.

(a) Plaintiffs in intervention are informed and believe and therefore allege the fact to be that continuously from about the year 1925 until his death in 1941 one Arthur Curtiss James directly and through companies known as A. C. James Co., Curtiss Southwestern Corporation and Curtiss Southwestern Company, the same being wholly

owned personal holding companies of the said James, owned 33,400 shares of the aforesaid outstanding preferred stock of said defendant in intervention, "Corporation," or approximately 8.8% of its total outstanding preferred stock, and 352,390 shares of the aforesaid outstanding common stock of said "Corporation" or approximately 61.5% of its total outstanding common stock; that the aforesaid stock holdings of the said James in said "Corporation" amounted to approximately 40% of its total outstanding voting stock, namely, the total outstanding preferred and common stock of said defendant in intervention, "Corporation"; that the balance of said outstanding stock of said "Corporation" was widely dispersed and held by numerous stockholders; that the said James directly and through his aforesaid personal holding companies, also owned a substantial amount of the secured bonds of said defendant in intervention, "Railroad Company," and was one of the dominant interests actively participating in the aforesaid proceedings for the reorganization of said "Railroad Company" and in addition the said personal holding companies of the said James held as collateral security for certain alleged loans to said defendant in intervention, "Corporation," the aggregate face amount of \$5,980,000 of First Mortgage 5% Gold Bonds, Series A, due 1946 of said The Western Pacific Railroad Company, viz, the "Railroad Company," which bonds were owned by said "Corporation" but for which the aforesaid James' interests acted in said

reorganization through the aforesaid Robert E. Coulson, one of the Reorganization Committee of said "Railroad Company."

(b) The said Arthur Curtiss James died in the year 1941 and thereupon, pursuant to the provisions of his last will and testament, the aforementioned James Foundation of New York, Inc., a New York Corporation (referred to herein as the "Foundation") was organized and said "Foundation" thereupon succeeded to and became the owner of all the above-mentioned assets of the said James and his said personal holding companies; that accordingly ever since approximately the year 1941 said "Foundation" has continuously been and now is the holder of said 33,400 shares of said preferred stock and said 352,390 shares of said common stock in said defendant in intervention, "Corporation," representing, as aforesaid, approximately 40% of its outstanding voting stock and resulting, so plaintiffs in intervention are informed and believe and therefore allege the fact to be, in the absolute control and domination of said defendant in intervention, "Corporation," by said "Foundation," the balance of the outstanding voting stock of said "Corporation" being widely dispersed and held by numerous stockholders, including, as to the balance of said preferred stock, these plaintiffs in intervention; that in succeeding to the aforesaid assets of the said James and his said personal holding companies, as aforesaid, said, the "Foundation" also received and became the owner of the above-mentioned secured bonds of defendant in intervention, "Railroad Com-

pany," and the above-mentioned collateral loan secured by said \$5,980,000 in face amount of first mortgage bonds of said "Railroad Company," which last mentioned bonds were owned as aforesaid by said "Corporation"; that the said "Foundation" continued to actively participate in the aforesaid reorganization of said defendant in intervention, "Railroad Company," through the said Robert E. Coulson and pursuant to the aforementioned agreement dated as of November 22, 1943, by and between said "Corporation" and said "Foundation" and said Reorganization Committee of said "Railroad Company" and others, said collateral, to wit, \$5,980,000 in face amount of First Mortgage 5% Gold Bonds, Series A, due 1946 of said "Railroad Company" was transferred together with other securities belonging to said "Corporation" to said "Foundation" in purported satisfaction of said collateral loan; that pursuant to the above-mentioned plan of reorganization of said defendant in intervention, "Railroad Company," which plan was finally confirmed by the court in said reorganization proceedings on or about October 11, 1943, as aforesaid, and as a result thereof, said "Foundation" by virtue of its above-described interests in said "Railroad Company" received new securities therein amounting to more than 25% of the outstanding stock of said reorganized "Railroad Company" and millions of dollars of its bonds; that as of April 22, 1946, said "Foundation" was the largest stockholder of said defendant in intervention, "Railroad Company," holding 55,727 shares out of a total of

318,502 outstanding shares of the preferred stock of said "Railroad Company" and 153,165 shares out of a total of 408,283 outstanding shares of its common stock; that plaintiffs in intervention are informed and believe and therefore allege the fact to be that said "Foundation" has held said stock and said new bonds continuously since the consummation of said plan of reorganization on or about December 29, 1944, as aforesaid, and does now hold the same and by virtue thereof has continuously dominated and controlled said defendant in intervention, "Railroad Company."

(c) Plaintiffs in intervention are informed and believe and therefore allege the fact to be that by virtue of the aforesaid stock ownerships and control the said Arthur Curtiss James during his lifetime and the said James Foundation of New York, Inc., viz, the "Foundation," subsequent to his death, have at all the times herein mentioned continuously dominated and controlled the defendants in intervention, to wit, the "Corporation," the "Railroad Company," the "Railroad Group" and The Western Realty Company and have caused to be elected as officers and directors of said companies persons who acted in the interest and for the benefit of the aforesaid James' interests and failed to exercise their independent judgment on behalf of said companies and their stockholders in matters involving the personal interest of the said James and said "Foundation" to the detriment of said "Corporation" and its remaining stockholders; that said

“Foundation” has continuously since its organization in or about the year 1941 and does now dominate and control the defendant in intervention, “Corporation,” and has continued to elect officers and directors previously elected by the said James and others of its own choosing, certain of whom, as is more specifically hereinafter alleged, have directed and controlled the management of said “Corporation” and all of whom have acted as the agents of said “Foundation” and not independently for the best interests but to the detriment of said “Corporation” and its remaining stockholders; that specifically with respect to the transactions of which plaintiffs in intervention complain herein and which are hereinafter particularly alleged, the following persons acted and/or are now acting in the following capacities for said “Corporation” and said “Foundation” or said “Railroad Company,” to wit:

1. The said Robert E. Coulson and one William W. Carman have been officers and trustees of said James Foundation of New York, Inc., viz, the “Foundation” continuously since its organization and now are officers and trustees thereof; that both the said Coulson and Carman have acted on behalf of the said Arthur Curtiss James and said “Foundation” as officers, directors or employees of said defendants in intervention, “Corporation,” and/or “Railroad Company”; that the said Coulson was a director of said “Corporation” from prior to the year 1941 to on or about February 19, 1942, and was also a member of the Reorganization Commit-

tee of said "Railroad Company" during said reorganization proceedings and as such was one of the signatories to the aforementioned agreement dated as of November 22, 1943; that ever since said reorganization the said Coulson has been and now is a director of said defendant in intervention, "Railroad Company"; that at all the times herein mentioned the said Coulson has been and now is a partner in the firm of Messrs. Whitman, Ransom, Coulson & Goetz, 40 Wall Street, New York City, which firm appears in the present action as attorneys for defendant in intervention, The Western Realty Company, which is now a wholly owned subsidiary of said "Foundation"; that said Messrs. Whitman, Ransom, Coulson & Goetz and the said Coulson have been at all the times herein mentioned and now are the attorneys for said "Foundation"; that said firm and the said Coulson were retained by the Reorganization Trustees in the aforesaid reorganization of defendant in intervention "Railroad Company" as tax counsel for said "Railroad Company" and its subsidiaries and as such handled all matters pertaining to the hereinafter mentioned transactions which are complained of herein; that with respect to said transactions the officers and directors of said defendant in intervention "Corporation" failed and refused to retain independent tax counsel for said "Corporation" and accepted and relied upon the advice of said Messrs. Whitman, Ransom, Coulson & Goetz as to the rights of said "Corporation" with full knowledge that said firm represented said "Railroad Company" and its

subsidiaries and was being compensated thereby; that as is hereinbefore alleged the said William W. Carman has at all times been and now is a trustee and an officer, to wit, president, of said "Foundation" and the said Carman executed the aforementioned agreement dated as of November 22, 1943, on behalf of said "Foundation" as its president; that the said Carman was likewise a director of said defendant in intervention "Corporation" from prior to the year 1941 to and including the year 1944.

2. Continuously since approximately the year 1941 one Michael J. Curry has been and now is an officer and director of said defendant in intervention, "Corporation"; that the said Curry was formerly secretary and treasurer of said "Corporation" and since some time during the year 1943 has been and now is its president; that the said Curry executed the aforementioned agreement dated as of November 22, 1943, on behalf of said "Corporation" as its president; that at all the times herein mentioned the said Curry has also been and now is an employee of said defendant in intervention "Railroad Company" being employed by it in connection with tax matters through arrangement made with said "Railroad Company" by the said Robert E. Coulson on behalf of his said law firm.

3. Continuously since the year 1945 one Mary C. Valouch has been and now is a director and officer, to wit, vice president and secretary, of said defendant in intervention "Corporation"; that during said time the said Mary C. Valouch has been and now is an employee in the office of said tax counsel for said defendant in intervention "Railroad Company."

4. Continuously since prior to the year 1941 one Thomas M. Schumacher has been and now is a director of said defendant in intervention "Corporation" and was president thereof from some time prior to the year 1941 until succeeded by the said Michael J. Curry in the year 1943, as aforesaid; that the said Schumacher was likewise one of the Reorganization Trustees in the aforesaid reorganization of said defendant in intervention "Railroad Company" from on or about September 23, 1935, to on or about December 29, 1944.

5. During all the times herein referred to Messrs. Pierce & Greer of New York were general counsel for both said defendants in intervention "Corporation" and "Railroad Company."

(d) Plaintiffs in intervention are informed and believe and therefore allege the fact to be that in addition to the above-mentioned persons certain other directors of defendant in intervention "Corporation" were at all the times herein mentioned and now are, employees of said "Foundation" or said defendant in intervention "Railroad Company," directly or indirectly, with the result that the offi-

cers and board of directors of said "Corporation" were and now are completely dominated and controlled by said "Foundation" and said "Railroad Company"; that all compensation received by said last-mentioned persons and said above-named persons and counsel have been paid and is now being paid directly or indirectly by said "Foundation" or said "Railroad Company."

VIII.

(a) Plaintiffs in intervention are informed and believe and therefore allege the fact to be that during the years 1942, 1943 and 1944 the said defendant in intervention "Railroad Company" through its Reorganization Trustees and its aforesaid tax counsel and the officers and directors of said defendant in intervention "Corporation" and the aforesaid officers and trustees of said "Foundation" conceived a plan to confer upon said "Railroad Company" and its subsidiaries a federal income and excess profits tax saving in the approximate total amount of \$14,301,821.54 without any benefit or consideration whatsoever to said "Corporation" by (1) causing said defendant in intervention "Corporation" to file consolidated income and excess profits tax returns for the years 1942, 1943 and 1944 for all the defendants in intervention herein as the parent corporation of an affiliated group of corporations within the meaning of Section 141 of the Internal Revenue Code at a time when said defendant in intervention "Corpora-

tion" had been stripped of its aforesaid holdings in said "Railroad Company" and had no duty or obligation whatsoever so to do; and by (2) including in said consolidated returns the aforesaid capital losses of said "Corporation" consisting chiefly of the aforesaid loss of stock holdings in said "Railroad Company" thereby reducing to zero the tax bill of said "Railroad Company" and its subsidiaries; that pursuant to said plan said defendant in intervention "Corporation" was caused to file on or about July 15, 1944, such consolidated return for the year 1943 wherein losses were reported as having been incurred in said year 1943 and as deductible on behalf of said group, which losses consisted chiefly of the aforesaid capital loss of defendant in intervention "Corporation" resulting from the aforesaid finding in said plan of reorganization finally confirmed by the court in said reorganization proceedings on or about October 11, 1943, as aforesaid, that its aforementioned stock in said defendant in intervention "Railroad Company" was wholly worthless and without equity or value; that the aforesaid use of said loss on a consolidated basis resulted in the elimination of all taxable income for said defendant in intervention "Railroad Company" and its subsidiaries for the year 1943 and also provided unused credit balances to carry back to the year 1942 and to carry forward to the year 1944 sufficient to eliminate all taxable income for 1942 and the first four months of 1944; that said defendant in inter-

vention "Railroad Company" and its subsidiaries were thereby saved approximately the sum of \$7,100,000 in income and excess profits taxes which would have otherwise been payable by them for the year 1943; that based upon the aforementioned carry back of the unused credit balance of said loss to the year 1942 the said defendant in intervention "Corporation" was caused to file with the Federal Collector of Internal Revenue in the Second District of New York on or about March 9, 1945, a claim for refund in the sum of \$4,201,821.54 theretofore paid by the Reorganization Trustees of said "Railroad Company" as income and excess profits taxes for the year 1942, together with interest thereon, substantially all of which sum represents income and excess profits taxes payable by said defendant in intervention "Railroad Company" on its income and profits for the year 1942; that based upon the aforesaid carry forward of the unused credit balance of said loss to the year 1944 said defendant in intervention "Corporation" was caused to file in the year 1945 such consolidated income and excess profits tax return for the year 1944 and included therein the income of defendant in intervention "Railroad Company" and its subsidiaries for the first four months of 1944, to wit, the period January 1st to April 30, 1944; that thereby said defendant in intervention, "Railroad Company," and its subsidiaries were saved an additional sum of approximately \$3,000,000 in income and excess profits taxes which would have other-

wise been payable by them for the first four months of 1944.

(b) Said consolidated tax returns for the years 1943 and 1944 and said refund claim for the year 1942 were so filed after the aforesaid final adjudication on or about October 11, 1943, by the Court in said reorganization proceeding that said "Corporation's" stock holdings in said, "Railroad Company," were wholly worthless and without equity or value as found by the Interstate Commerce Commission on or about June 21, 1939, and affirmed by the Supreme Court of the United States on or about March 11, 1943, as aforesaid, and after the transfers of the properties belonging to said "Corporation" which were provided for in said agreement dated as of November 22, 1943, as aforesaid; that the date established in said returns as the date of severance of the affiliation of said defendants in intervention within the meaning of said Section 141 of the Internal Revenue Code was April 30, 1944, which, so plaintiffs are informed and believe and therefore allege the fact to be, was the date as of which said "Corporation's" said stock in said "Railroad Company" was transferred to the Reorganization Committee of said "Railroad Company" pursuant to said agreement of November 22, 1943; that said defendant in intervention "Corporation" had no taxable earnings or income or profits for the years 1942, 1943 or 1944, and no federal income or excess profits taxes were payable by it; that under the provisions of the Internal

Revenue Code and the rules and regulations promulgated thereunder said defendant in intervention "Corporation" was not obligated to file such consolidated returns for the years 1942, 1943 or 1944, but was entitled to elect to file separate returns solely in its own behalf reporting its said losses for its own possible future benefit and having lost all its aforesaid interests in said "Railroad Company" said "Corporation" was under no obligation whatsoever to said "Railroad Company" and its subsidiaries, or any thereof, legal, moral, financial or otherwise, to file said consolidated returns and refund claim and thus enable said defendants in intervention to effect a tax saving in excess of \$14,300,000 for themselves without any benefit or consideration whatsoever to said defendant in intervention "Corporation."

(c) Plaintiffs in intervention are informed and believe and therefore allege the fact to be that the above-mentioned transactions, to wit, the filing of said consolidated tax returns and said refund claim on the basis of the aforesaid capital loss suffered by defendant in intervention "Corporation," as aforesaid, were accomplished by said defendant in intervention "Railroad Company" and its Reorganization Trustees and aforesaid tax counsel and said "Foundation" through the above-named persons and others who occupied fiduciary and controlling positions in said "Corporation" and similar positions with respect to said "Railroad Company" or "Foundation" and whose interests were best

subverted by favoring said "Railroad Company" and consequently said "Foundation" through its aforesaid holdings therein, at the expense of said "Corporation" and which persons were and still are dominated and controlled by said "Foundation" and said "Railroad Company"; that the interests of said defendant in intervention "Corporation" and its stockholders other than said "Foundation" were not represented by independent officers, directors or counsel; that by virtue of its aforesaid valuable and dominating interests in said defendant in intervention "Railroad Company" as compared with its aforesaid stock holdings in the inactive and impecunious "Corporation" it was and is greatly to the financial interest and advantage of said "Foundation" to have the aforementioned tax savings accrue to said "Railroad Company" and its subsidiaries and to deprive the said "Corporation" thereof; that the said transactions were unfair and inequitable to said defendant in intervention "Corporation" in that (1) said "Corporation" was thereby caused to cede to said defendant in intervention "Railroad Company" and its subsidiaries the right to utilize the capital losses of said "Corporation" the use of which resulted in tax savings including said refund claim in excess of \$14,300,000 for said "Railroad Company" and its subsidiaries for which said "Corporation" has to date received no benefit or consideration whatsoever, and (2) said transactions were in violation of recognized and good accounting practice in such

situations under which said "Corporation" should receive the amount of said tax savings from said "Railroad Company" and its subsidiaries and the proceeds of said refund claim when paid by the government as partial offsets against its said capital losses; that the officers and directors of said "Corporation" equitably and pursuant to recognized and good accounting practice and in the proper exercise of their fiduciary duty to all the stockholders thereof should have demanded and obtained for said "Corporation" through prior arrangement with the remaining defendants in intervention, said tax savings and refund claim or a fair and proper proportion thereof for the aforesaid use of said capital losses and as partial offsets against the same.

(d) No final action has as yet been taken by the government on said claim for refund for the year 1942 in the aforesaid amount of \$4,201,821.54 and interest filed as aforesaid on or about March 9, 1945, and plaintiffs in intervention are informed and believe and therefore allege the fact to be that said consolidated tax returns for the years 1943 and 1944, to wit, said tax savings of approximately \$7,100,000 and \$3,000,000, respectively, have not as yet been finally audited and allowed by the government; that favorable action on said claim for refund will result in payment by the United States Government to said defendant in intervention "Corporation" as such parent corporation of said sum of \$4,201,821.54, together with interest, and favorable action in the final audit of said consolidated returns

for the years 1943 and 1944 will result in a total tax saving to defendant in intervention "Railroad Company" and its subsidiaries of approximately \$10,100,000 for which a reserve fund has been established by said defendant in intervention "Railroad Company" in said amount; that said defendant in intervention "Railroad Company" claims the whole of said refund claim and all proceeds therefrom and said tax savings to the prejudice of said "Corporation" and its stockholders.

IX.

(a) On or about June 27, 1946 plaintiffs in intervention herein Russell M. Van Kirk and Henry Offerman commenced a stockholders action in the United States District Court for the Southern District of New York, No. Civ. 36-584 therein, against the said Robert E. Coulson, William W. Carman, Michael J. Curry, Thomas M. Schumacher and Mary C. Valouch and certain other individuals and said James Foundation of New York, Inc., viz, the "Foundation," The Western Pacific Railroad Company, viz, the "Railroad Company" and The Western Pacific Railroad Corporation, viz, the "Corporation" as defendants, which action is still pending undetermined in said court; that in said action said plaintiffs in intervention are presently attacking the aforementioned agreement dated as of November 22, 1943, between said "Corporation," said "Foundation" and the Reorganization Committee of said "Railroad Company" and others pursuant

to which, among other things, said \$5,980,000 in face amount of first mortgage bonds of said "Railroad Company" and all the outstanding stock in said, The Western Realty Company, all of which securities were owned by defendant in intervention "Corporation," were transferred to said "Foundation," as aforesaid, and in which said action said plaintiffs in intervention seek, among other things, to recover said securities or the value thereof and also seek to recover said above-mentioned tax savings and refund claim in the approximate total amount of \$14,301,821.54,* as aforesaid, in the right of said "Corporation" and for the benefit of its stockholders; that in said action the aforesaid firm of Messrs. Whitman, Ransom, Coulson & Goetz appear as the attorneys for the defendants therein, Robert E. Coulson and said "Foundation" and said Messrs. Pierce & Greer appear as the attorneys for the defendant therein "Corporation" and others that defendant in intervention herein "Railroad Company" is not subject to the jurisdiction of the court in said action and has not appeared therein although named as a defendant, as aforesaid; that on or about September 24, 1946, motions to dismiss said action by the defendants Coulson and James Foundation of New York, Inc., therein were denied by the court; that thereupon, to wit, on or about October 10, 1946, the defendant in intervention herein, The Western Pacific Railroad Corporation, viz, the "Corporation," being also a defendant in said New York action, was caused by its aforesaid

officers, directors and counsel to file the present action in this court, to wit, No. 26508-G, herein with respect to said tax savings and refund claim which are also involved, as aforesaid, in said New York action; that plaintiffs in intervention are informed and believe and therefore allege the fact to be that at no time prior to the filing of the present action in this court, on or about October 10, 1946, as aforesaid, did the present officers or directors of said "Corporation" ever assert any claim whatsoever on its behalf to said tax savings or refund claim or any thereof, but on the contrary the said officers and directors of said defendant in intervention "Corporation" with full knowledge of all the facts which are hereinbefore alleged and being dominated and controlled by and acting for the benefit of said "Foundation" and said "Railroad Company" to the detriment of said "Corporation," as aforesaid, have conceded the aforesaid claim of said "Railroad Company" to said tax savings and refund claim; that plaintiffs in intervention are further informed and believe and therefore allege the fact to be that the present action filed in this court by said defendant in intervention "Corporation" on or about October 10, 1946, as aforesaid, was commenced by the present officers and directors of said "Corporation" in the interest of said "Foundation" and "Railroad Company" and by virtue of the domination and control of said officers and directors by said "Foundation" and "Railroad Company" for the purpose of obtaining

an adjudication in this court on said tax savings and refund claim without allegation or proof of the facts which are hereinbefore alleged with respect to the domination and control of said "Corporation" by said "Foundation" and "Railroad Company" and the respective interests and situations of said companies at the time of said transactions, which adjudication if favorable to said "Railroad Company" and its subsidiaries might constitute a bar to the relief sought in this respect by said plaintiffs in intervention in said New York action; that A. Perry Osborn, Esq., 20 Exchange Place, New York, who appears of counsel for said defendant in intervention "Corporation" in the present action, is one of the present directors of said "Corporation"; that said defendant in intervention "Railroad Company" and its subsidiaries, said "Foundation" and its aforesaid officers and trustees and the present officers, directors and counsel for said "Corporation," and each of them, have at all the times herein mentioned had and do now have knowledge or notice of all the facts which are hereinbefore alleged.

(b) Plaintiffs in intervention have not requested said defendant in intervention "Corporation" or its present officers or directors to bring action against the remaining defendants in intervention herein with respect to the subject matter of this action in intervention for the reason that the aforesaid officers and directors who presently control said "Corporation" participated in the wrongs

which are complained of herein and are themselves dominated and controlled by said "Foundation" and "Railroad Company"; that any demand upon said defendant in intervention "Corporation" or its present officers and directors to seek redress of the wrongs complained of herein would in effect have been a demand that they disclose their own failure to perform their duties and to act independently for said "Corporation" and its stockholders and would have been futile; that by reason of the foregoing facts the representation herein of the interest of plaintiffs in intervention by the present officers, directors and counsel for defendant in intervention "Corporation" is wholly inadequate; that plaintiffs in intervention have no adequate remedy at law.

And for a second cause of action, plaintiffs in intervention allege:

I.

Plaintiffs in intervention refer to Paragraphs I to IX inclusive of their first cause of action herein and by such reference incorporate the same in this their second cause of action.

II.

As hereinbefore alleged there was pending in the above-entitled court from on or about August 2, 1935, to on or about March 28, 1946, that certain reorganization proceeding under Section 77 of the National Bankruptcy Act entitled "In the Matter

of The Western Pacific Railroad Company, Debtor," No. 26591-S, in said court; that on or about March 28, 1946, an order was made and entered by the court finally terminating said reorganization proceedings and containing certain reservations of jurisdiction and restraining orders, which final order is of record in the files of this court; that by virtue of all the facts which are hereinbefore alleged, plaintiffs in intervention request either (a) an adjudication herein that said final order of March 28, 1946, does not restrain or prevent the prosecution of the cause of action which is herein alleged, or (b) a modification of said order so as to permit the prosecution of said cause of action and the claims which are asserted herein; that jurisdiction therefor is based upon the bankruptcy jurisdiction of this court in the aforesaid reorganization proceeding.

Wherefore, plaintiffs in intervention pray for the order, judgment and decree of this Honorable Court as follows, to wit:

(a) Ordering and directing said defendant in intervention, The Western Pacific Railroad Company, viz, the "Railroad Company" and its said subsidiaries and defendant in intervention, The Western Realty Company, to account to defendant in intervention, The Western Pacific Railroad Corporation, viz, the "Corporation" for the aforesaid total tax savings for the years 1942, 1943 and 1944 amounting, as aforesaid, including said claim for refund, to the approximate total sum of \$14,301,-

821.54, together with interest thereon at the legal rate;

(b) Ordering and directing said defendant in intervention "Railroad Company" to immediately pay over to said defendant in intervention "Corporation" said tax savings of said "Railroad Company" and its subsidiaries, for the years 1943 and 1944 amounting, as aforesaid, to the approximate sum of \$10,100,000, together with interest thereon, at such time or times as said tax savings, or any thereof, are finally audited and allowed by the proper tax authorities of the United States Government;

(c) Declaring and determining that said defendant in intervention, The Western Pacific Railroad Corporation, viz, the "Corporation" is the sole owner of and is exclusively entitled to said refund claim respecting said tax saving for the year 1942 and all sums refundable thereunder amounting, as aforesaid, to the sum of \$4,201,821.54, together with interest thereon, and quieting the right and title of said defendant in intervention "Corporation" therein and thereto against the claims of defendant in intervention "Railroad Company" and all other parties to this action, and declaring that said defendant in intervention "Corporation" is entitled to retain as against all other defendants in intervention herein any and all proceeds from said refund claim for its own use and benefit;

(d) Either declaring and determining that said final order of March 28, 1946, in said reorganization

proceeding, No. 26591-S, herein, does not restrain or prevent the prosecution of the claims which are herein made on behalf of said defendant in intervention "Corporation" to said tax savings and refund claim, or modifying said order of March 28, 1946, so as to permit the prosecution of said claims;

(e) Requiring said defendants in intervention to pay to plaintiffs in intervention their reasonable expenses incident to the prosecution of this action, including reasonable counsel fees, and

(f) For such other and further relief as to this Honorable Court may seem meet and equitable in the premises.

Dated: March 10, 1947.

ROGER AND CLARK,

/s/ WEBSTER CLARK,

/s/ DAVID FRIEDENRICH,

Attorneys for Plaintiffs in Intervention Russell M. Van Kirk, Henry Offerman and J. S. Farlee & Co., Inc., a corporation.

Of counsel:

POMERANTZ, LEVY, SCHREIBER
& HAUDEK.

State of California,
City and County of San Francisco—ss.

Webster V. Clark, being first duly sworn, deposes and says:

That he is an attorney at law duly licensed and admitted to practice before all the courts of the State of California and the above-entitled court; that he is a member of the firm of Rogers and Clark, with offices at 111 Sutter Building, San Francisco, California, attorneys for plaintiffs in intervention in the above-entitled action; that the facts in the above entitled action are within the personal knowledge of affiant; that he has read the foregoing Complaint in Intervention and knows the contents thereof and the same is true of his own knowledge except as to those matters which are therein stated on information or belief and as to those matters that he believes it to be true; that the said plaintiffs in intervention are absent from the City and County of San Francisco where their said attorneys have their offices and for that reason affiant makes this verification on their behalf.

/s/ WEBSTER CLARK.

Subscribed and sworn to before me this 11th day of March, 1947.

[Seal] /s/ MARION CURTIS,
Notary Public in and for the City and County of
San Francisco, State of California.

My commission expires August 12, 1949.

[Endorsed]: Filed April 7, 1947.

[Title of District Court and Cause.]

ANSWER OF THE WESTERN PACIFIC
RAILROAD CORPORATION TO COM-
PLAINT IN INTERVENTION

The Western Pacific Railroad Corporation, plaintiff herein, for its Answer to the Complaint in Intervention filed by Russell M. Van Kirk, Henry Offerman and J. S. Farlee & Co., Inc., a corporation, respectfully shows and alleges as follows, to wit:

The plaintiff denies on its own behalf and on behalf of its officers and directors all allegations of the Complaint in Intervention of domination and control of the plaintiff, its officers and directors, by the James Foundation of New York, Inc., and The Western Pacific Railroad Company or any one or more of the subsidiaries or affiliates of either; as to all other allegations of the Complaint in Intervention plaintiff puts the plaintiffs in intervention to the proof thereof, and submits to the determination of the Court thereon.

Plaintiff alleges that it instituted and is prosecuting in the interest of its own stockholders the action set forth in the Bill of Complaint herein; it admits that said Railroad Company is wrongfully interposing as a defense to the cause of action alleged in the Bill of Complaint herein the Order of the Bankruptcy Court dated March 28, 1946, and avers that said Order does not restrain or prevent the prosecution of the cause of action as alleged in

the Bill of Complaint. Plaintiff submits that if said order be interpreted to bar the prosecution of the plaintiff's cause of action such interpretation is contrary to the true intent of the Court and that the Order should be modified so as to accurately express the intent of the Court and to permit the prosecution of said cause of action and the claims asserted by the plaintiff in its Bill of Complaint herein.

Wherefore, the plaintiff prays that plaintiff in intervention shall be required to proceed herein in subordination to the plaintiff and to the cause of action alleged by the plaintiff in its Bill of Complaint herein; and that Leroy R. Goodrich, attorney for the plaintiff, shall be designated as General Counsel to receive service of pleadings and other documents in this action; and that all papers shall issue out of or be served upon the office of such General Counsel, provided, however, that all papers served upon General Counsel for plaintiff shall include additional copies for transmission to Rogers and Clark, Webster V. Clark and David Freidenrich, attorneys for the plaintiffs in intervention.

THE WESTERN PACIFIC
RAILROAD CORPORATION,

By /s/ LEROY R. GOODRICH,
Its Attorney.

Of Counsel:

FRANK C. NICODEMUS, JR.,
A. PERRY OSBORN.

[Endorsed] Filed June 30, -1947.

[Title of District Court and Cause.]

ANSWER OF DEFENDANT THE WESTERN
REALTY COMPANY TO COMPLAINT IN
INTERVENTION

Comes now the defendant in intervention, The Western Realty Company, and answering the complaint in intervention herein, respectfully shows and alleges upon information and belief:

As to the First alleged cause of action:

1. Denies that it has any knowledge or information thereof sufficient to form a belief as to each and every allegation contained in Paragraphs I, IV and IX of said complaint.

2. Denies each and every allegation contained in Paragraph II of said complaint, except that said defendant admits that it is a Colorado corporation; that the defendant The Western Pacific Railroad Corporation is a Delaware corporation; that the defendants, The Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway, The Standard Realty and Development Company, and Delta Finance Co., Ltd., are California corporations, and that Deep Creek Railroad Company was formerly a Utah corporation and was dissolved prior to the commencement of this action.

3. Denies that it has any knowledge or information thereof sufficient to form a belief as to each and every allegation contained in subdivisions (a) and (b) of Paragraph III of said complaint, ex-

cept that said defendant admits that the matter in controversy exceeds, exclusive of interest and costs, the sum of \$3,000, and that the defendant, The Western Pacific Railroad Company was reorganized under section 77 of the National Bankruptcy Act in the proceeding in this court entitled "In the Matter of The Western Pacific Railroad Company, Debtor" (No. 26591-S).

4. Denies each and every allegation contained in subdivision (a) of Paragraph V of said complaint, except that said defendant admits that the defendants Sacramento Northern Railway and The Standard Realty and Development Company were and are wholly owned subsidiaries of the defendant, The Western Pacific Railroad Company; and denies that it has any knowledge or information thereof sufficient to form a belief as to each and every allegation contained in subdivisions (b) and (c) of Paragraph V of said complaint, except that said defendant admits that, from on or about June 4, 1920, to on or about May 15, 1944, all of its outstanding stock was held by the defendant, The Western Pacific Railroad Corporation; that the defendant, The Western Pacific Railroad Company, was reorganized under section 77 of the National Bankruptcy Act in the proceeding in this court entitled "In the Matter of The Western Pacific Railroad Company, Debtor" (No. 26591-S), and that the unsecured debts and capital stock of the defendant, The Western Pacific Railroad Company, were found to be without equity or value in said proceeding, which finding was ultimately sustained

by the Supreme Court of the United States on or about March 15, 1943.

5. Denies that it has any knowledge or information thereof sufficient to form a belief as to each and every allegation contained in subdivisions (a), (b) and (c) of Paragraph VI of said complaint, except that said defendant admits that the unsecured debts and capital stock of the defendant, The Western Pacific Railroad Company, were found to be without equity or value in the reorganization proceeding of the defendant, The Western Pacific Railroad Company, as aforesaid, and that on or about May 15, 1944, all of the outstanding stock of said defendant, The Western Realty Company, held by the defendant, The Western Pacific Railroad Company, was transferred to the James Foundation of New York, Inc.

6. Denies that it has any knowledge or information thereof sufficient to form a belief as to each and every allegation contained in subdivisions (a), (b), (c) and (d) of Paragraph VII of said complaint, except that said defendant admits that all of its outstanding stock has been held by James Foundation of New York, Inc., since on or about May 15, 1944; that Robert E. Coulson is a partner in the firm of Messrs. Whitman, Ransom, Coulson & Goetz, 40 Wall Street, New York, N. Y., which firm appears in this action as attorneys for said defendant, and that Michael J. Curry was formerly an officer of the defendant, The Western Pacific Railroad Corporation.

7. Denies each and every allegation contained in subdivision (a) of Paragraph VIII of said complaint, except that said defendant admits that, during the years 1942 and 1943 and the first four calendar months of 1944, the defendants in intervention constituted an affiliated group of corporations within the meaning of the Internal Revenue Code and income and excess profits tax returns were filed on a consolidated basis by the defendant, The Western Pacific Railroad Corporation on behalf of said affiliated group of corporations; that the consolidated returns for the year 1942 reported income and excess profits tax in the amount of \$4,201,821.54, the whole of which sum was paid in 1943 with funds supplied by the reorganization trustees of the defendant, The Western Pacific Railroad Company; that the consolidated returns for the year 1943 and the first four months of 1944 reported no taxable income, and that the defendant, The Western Pacific Railroad Corporation, filed in 1945 a claim for refund of said sum of \$4,201,821.54 theretofore paid as income and excess profits tax for the year 1942, together with interest thereon; and denies that it has any knowledge or information thereof sufficient to form a belief as to each and every allegation contained in subdivisions (b), (c) and (d) of Paragraph VIII of said complaint, except that said defendant admits that the consolidated tax returns for the year 1943 and the first four calendar months of 1944 were filed on or about July 15, 1944, and June 15, 1945, respectively, and that the claim for refund of the amount paid as

income and excess profits tax for the year 1942, as aforesaid, was filed on or about March 9, 1945.

As to the Second alleged cause of action:

1. Denies that it has any knowledge or information thereof sufficient to form a belief as to each and every allegation and reallegation contained in the second alleged cause of action set forth in said complaint, except as hereinabove otherwise specifically denied or admitted.

For a complete defense to the First and Second alleged causes of action:

1. The complaint in intervention fails to state a claim against the defendant, The Western Realty Company, upon which relief can be granted.

Wherefore, the defendant, The Western Realty Company, demands judgment that the complaint in intervention herein be dismissed as to said defendant, together with the costs and disbursements of this action.

PILLSBURY, MADISON
& SUTRO,

/s/ FELIX T. SMITH,
/s/ EVERETT A. MATHEWS,

WHITMAN, RANSOM,
COULSON & GOETZ,

Attorneys for Defendant, The Western Realty Company.

Receipt of copy attached.

[Endorsed]: Filed July 1, 1947.

[Title of District Court and Cause.]

ORDER DENYING APPLICATION FOR TEMPORARY RESTRAINING ORDER ON CONDITION, AND PRETRIAL ORDER

The application of interveners above named for a temporary restraining order enjoining and restraining the plaintiff and the defendants and each of them from consummating the settlement of tax liability to and refund claim against the United States, having come on before the court in open court in the courtroom of the above-entitled court in the Post Office Building, San Francisco, California, on Monday, the 25th day of August, 1947, the interveners appearing by Webster V. Clark, Esq., and David Freidenrich, Esq., and by Julius Levy, Esq., of the New York Bar, specially admitted for the purpose of presenting the motion of the interveners, and the plaintiff appearing by its attorney, Leroy R. Goodrich, Esq., and the defendant, Western Realty Company, appearing by its attorney, Everett Mathews, Esq., and the other defendants appearing by their attorneys, Messrs. Allan P. Matthew and James D. Adams, and the said interveners having filed the affidavit of Julius Levy in support of said application and proposed forms of temporary restraining order and order to show cause, and of temporary injunction, and the defendants having presented to the Court a form of stipulation between plaintiff and the defendants, in the form annexed to this order and marked

Exhibit A, and the said application having been presented by the interveners and opposed by the defendants on Monday, August 25, 1947, and on Tuesday, August 26, 1947, all parties being represented by their aforesaid counsel during the entirety of said hearing on both of said dates, and the court having considered the same; and

Said hearing having developed and clarified certain issues and contentions of the parties concerning the effect of the aforesaid settlement, as follows:

(a) Plaintiffs in Intervention having contended that, as set forth in the aforesaid affidavit of Julius Levy, the form of said proposed settlement will prejudice the cause of plaintiff and plaintiffs in intervention herein by subjecting that part thereof involving said claim for refund to certain technical defenses and other parts thereof to substantive disadvantages—all of which plaintiffs in intervention contend would not be otherwise applicable, and

(b) Plaintiff Corporation having contended that, by virtue of a stipulation to be entered into between said plaintiff and defendants, said settlement will merely reduce pro tanto the amount of the claim in litigation herein and will not subject any part of said claim either to any technical defenses or to any substantive disadvantages which would not have otherwise been applicable and will not prejudice or enhance the pre-existing rights or remedies of any party at the expense of any other; and

(c) Defendants (other than The Western Realty

Company) having contended that by virtue of said stipulation the settlement with the Government was made without prejudice to the respective claims and defenses of the parties to the litigation except that all those claims and defenses should be deemed to relate to a tax saving as reduced by settlement with the Government and that the claim for refund should be deemed to have been allowed in proportion which it bears to the total tax saving, and that the tax saving for the subsequent years should be deemed to have been reduced in like proportion and that the defenses of the parties should not be imperiled, waived or prejudiced nor should the claims be imperiled, waived or prejudiced except as all thereof relate to a fixed or determinable amount of tax saving in consequence of the settlement with the Government;

Now, Therefore, upon filing and considering the aforesaid affidavit of Julius Levy, the aforesaid proposed stipulation (Exhibit A), the minutes of the hearing herein and all of the papers and prior proceedings,

It is Hereby Ordered:

(1) That the application of interveners for a restraining order be and the same is hereby denied upon the condition that the defendants shall enter into a stipulation with the plaintiff in the form annexed hereto marked Exhibit A; and upon the further condition that said hearing upon said application of interveners shall be deemed a pretrial

hearing on the aforesaid issues as if properly noticed as such so that the Court may make and enter an appropriate pretrial order pursuant thereto; and

(2) That the aforesaid settlement with the United States Government shall have force and effect in this action and as between the parties hereto solely to the extent that it reduces pro tanto the total amount in controversy herein and that in all other respects this Court shall and does hereby preserve the respective rights and positions of all parties and shall determine the issues and give judgment herein, in the same manner as if said tax saving had been allowed and said refund claim allowed and paid by the United States Government in the ordinary course and manner prescribed by law and as proportionately reduced by said settlement.

Dated: August 29, 1947.

/s/ LOUIS E. GOODMAN,
District Judge.

Approved as to Form:

LEROY R. GOODRICH,
FRANK C. NICODEMUS, JR.,
A. PERRY OSBORN,

By /s/ LEROY R. GOODRICH,
Attorneys for Plaintiff.

ROGERS & CLARK,
WEBSTER V. CLARK,
DAVID FREIDENRICH,

POMERANTZ, LEVY,
SCHREIBER & HAUDEK,
JULIUS LEVY,

By /s/ WEBSTER V. CLARK,

Attorneys for Plaintiffs in
Intervention.

ALLAN P. MATTHEW,
JAMES D. ADAMS,
ROBERT L. LIPMAN,
BURNHAM ENERSEN,
McCUTCHEN, THOMAS,
MATTHEW, GRIFFITHS
& GREENE,

By /s/ JAMES D. ADAMS,

Attorneys for Defendants Other Than The Western
Realty Company.

[Endorsed]: Filed August 29, 1947.

[Exhibit A attached to the preceding Order is identical to the Stipulation and Agreement between plaintiff and defendants relating to agreement with the Bureau of Internal Revenue. See pages 168 to 175 inclusive.]

[Title of District Court and Cause.]

STIPULATION AND AGREEMENT BETWEEN PLAINTIFF AND DEFENDANTS RELATING TO AGREEMENT WITH THE BUREAU OF INTERNAL REVENUE

1. The Bureau of Internal Revenue has accepted a proposal for the settlement of corporation income and excess profits tax liability on behalf of the parties hereto, copies of which said proposal and acceptances are annexed hereto marked Exhibit A.

2. It is stipulated and agreed as follows:

(a) That the approval and acceptance of such settlement by the plaintiff and the defendants shall be without prejudice to the interests, claims or defenses asserted by the parties hereto, respectively, in the subject matter of this action and without prejudice to the position of the said parties inter se with respect thereto, and that all the interests and claims asserted by the said parties are to be determined with relation to, and as limited to, the net amount of alleged tax saving involved in this action as diminished by the settlement.

(b) More particularly, the claim for refund

of taxes paid for the year 1942 shall not be deemed to have been abandoned by said settlement, but on the contrary said refund claim shall be deemed to have been diminished in the proportion in which the aggregate of the tax savings involved in this action shall have been diminished by the settlement, and as so diminished to have been allowed, paid to the plaintiff as the agent for the affiliated group designated in Regulations 104 and 110, and by the plaintiff paid into court, and the tax savings for the year 1943 and for the first four months of 1944 shall be deemed to have been diminished in like proportion. Nothing herein contained shall obligate any party hereto to make any deposit or payment into court.

(c) By acquiescence in such settlement none of the parties hereto waives any of its interests, claims or defenses in the above-entitled action, as against any other party, but all such interests, claims and defenses shall relate to the amount of tax savings as diminished by said settlement, and all parties stipulate and agree that the aggregate amount of the tax savings involved in or claimed in said action has been diminished by said settlement by the amount of \$4,201,821.54.

(d) Nothing herein contained shall be deemed to be or constitute a recognition or admission on the part of any party of the validity, merit or equity of the claims of any other party to said tax savings as reduced, or to any part thereof, or a waiver, surrender, or relinquishment in any manner

or to any extent of the defenses or any thereof of any party to the claims of any other party in and to such tax savings, as reduced.

(e) In the event the said tax liabilities of the parties hereto shall not be finally settled in accordance with said agreement with the Bureau of Internal Revenue, this stipulation shall be of no force or effect whatsoever, and all the parties shall be released herefrom with like effect as if this stipulation had never been made.

Dated September 3, 1947.

/s/ LEROY R. GOODRICH,

/s/ F. C. NICODEMUS, JR.,

Attorneys for Plaintiff, The Western Pacific Railroad Corporation.

/s/ ALLAN P. MATTHEW,

/s/ JAMES D. ADAMS,

/s/ ROBERT L. LIPMAN,

/s/ BURNHAM EVERSON,

McCUTCHEN, THOMAS,

MATTHEWS, GRIFFITHS,

& GREENE,

Attorneys for Defendants, The Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway Company, Delta Finance Co., Ltd., and Standard Realty and Development Company.

PILLSBURY, MADISON
& SUTRO,

/s/ FELIX T. SMITH,

/s/ EVERETT A. MATHEWS,

WHITMAN, RANSOM,
COULSON & GOETZ,

By /s/ EVERETT A. MATHEWS,

Attorneys for Defendant, The
Western Realty Company.

EXHIBIT A

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York 5, N. Y.

February 11, 1947.

The Honorable Joseph D. Nunan, Jr.,
Commissioner of Internal Revenue,
Washington, D. C.

Attention: Mr. Frank Eddingfield.

Re: The Western Pacific Railroad Corpora-
tion and Affiliated Corporations 1942,
1943 and 1944 Federal Income Taxes.

Dear Sir:

The Western Pacific Railroad Corporation and
its affiliated subsidiaries filed consolidated returns

for the calendar years 1942 and 1943 and the said Western Pacific Railroad Corporation filed a consolidated return for the calendar year 1944 including therein its said subsidiaries for the period from January 1, 1944, to April 30, 1944, during which period affiliation existed.

On the said return for 1942 a consolidated tax liability of \$4,201,821.54 was reported and duly assessed and paid. On the said return for 1943 there was reported a net loss and no taxable income. On the said return for 1944, based on a carryover of the unused 1943 net loss, there was reported no taxable income and no tax liability. A claim for refund of the tax so paid for 1942, based on a carryback of the said 1943 net loss, was filed and is now pending in your office.

The taxpayer on behalf of itself and its aforesaid affiliated subsidiaries hereby offers to settle and determine the tax liabilities of the said corporations for the said taxable years 1942, 1943 and 1944 in the amounts shown on the returns filed as aforesaid. This proposal of settlement does not relate to or affect the tax liability of the said subsidiaries from and after April 30, 1944, when their affiliated status with The Western Pacific Railroad Corporation was terminated. The within proposal is made without prejudice to any rights or claims of the parties, if the proposal is not accepted by you.

As part of this proposal The Western Pacific Railroad Corporation, on behalf of itself and its

aforesaid affiliated subsidiaries agrees that, if this proposal is accepted, it will consent to a rejection of the said claim for refund of the 1942 taxes and further agrees not to sue upon said claim or file other or further claims in respect of 1942 taxes on any ground whatsoever. It is further agreed by the said The Western Pacific Railroad Corporation on behalf of itself and its aforesaid affiliated subsidiaries that if this proposal is accepted it will execute or procure the execution of any other or further agreements or assurances requested by the Commissioner of Internal Revenue for the purpose of effectuating the settlement.

Authority for the submission of the within proposal of settlement by the undersigned is contained in a Power of Attorney heretofore filed in your office.

Respectfully,

THE WESTERN PACIFIC
RAILROAD CORPORATION,
JAMES K. POLK,
Attorney-in-Fact.

Treasury Department
Washington 25

Aug. 13, 1947.

Office of
Commissioner of Internal Revenue

Address Reply to
Commissioner of Internal Revenue
and refer to
IT:R:A-4
JES

The Western Pacific Railroad Corporation
and Affiliated Companies,
c/o Mr. James K. Polk,
40 Wall Street,
New York 5, New York.

In re: Years—1942, 1943 and 1944.

Gentlemen:

Reference is made to your letter dated February 11, 1947, regarding the examination of income and profits tax returns for the years indicated above.

You are advised that all the administrative action in connection therewith, based upon the record supplied this office by the internal revenue agent in charge, has been completed and the returns placed in the closed files.

Very truly yours,

E. J. McLARNEY,
Deputy Commissioner.

Treasury Department
Washington 25

Aug. 26, 1947.

Office of
Commissioner of Internal Revenue

Address Reply to
Commissioner of Internal Revenue
and refer to
IT:C1:CC: Rej

The Western Pacific Railroad Corp.,
c/o Mr. J. K. Polk,
40 Wall Street,
New York 5, New York.

In re: Claims for refund of \$4,201,821.54,
\$7,454.73 and \$161,449.48.

For the year 1942

Gentlemen:

In accordance with the provisions of section 3772(a)(2) of the Internal Revenue Code, this notice of disallowance in full of your claim or claims is hereby given by registered mail.

By direction of the Commissioner:

Very truly yours,

E. J. McLARNEY,
Deputy Commissioner.

994M

[Endorsed]: Filed September 5, 1947.

[Title of District Court and Cause]

ANSWER OF THE WESTERN PACIFIC
RAILROAD COMPANY ET AL TO COM-
PLAINT IN INTERVENTION

Come now defendants, The Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway Company, Delta Finance Co., Ltd., and Standard Realty and Development Company, and pursuant to order of court and without waiving any of the objections to the complaint in intervention made by defendants' motions to strike portions of that complaint, and specifically reserving the right to make further objections and to assert further defenses to that complaint by way of answer, motion or otherwise after a ruling upon those motions, allege by way of answer to the complaint in intervention as follows:

I.

Defendants admit the allegations of paragraph I.

II.

Defendants admit the allegations of paragraph II except that defendants allege that Deep Creek Railroad Company was in liquidation in 1942, 1943 and 1944 and was finally dissolved in 1944.

III.

Answering the allegations of paragraph III, defendants admit the allegations of subparagraph (a). They further admit that defendant The Western

Pacific Railroad Company was in reorganization from August 2, 1935, to March 28, 1946, and that from on or about September 23, 1935, to December 29, 1944, the properties of defendant The Western Pacific Railroad Company were held and operated by the Reorganization Trustees. Defendants deny the remaining allegations of paragraph III.

IV.

Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph IV and on that ground they deny them.

V.

Answering paragraph V, defendants admit the allegations of subparagraph (a). They further admit that prior to April 30, 1944, plaintiff owned all the stock of defendant The Western Pacific Railroad Company; that plaintiff also owned the stock of The Western Realty Company and fifty per cent of the stock of The Denver and Rio Grande Western Railroad Company; that defendant The Western Pacific Railroad Company was in reorganization from August 2, 1935, to March 28, 1946; that the Interstate Commerce Commission, this Court and the Supreme Court determined in connection with the reorganization that the stock of defendant The Western Pacific Railroad Company was without equity or value; that an agreement was made as of November 22, 1943, providing among other things for the transfer of that

stock to the reorganization committee appointed in the reorganization proceeding; that the transfer took place on or about April 30, 1944; that on December 29, 1944, the reorganization trustees returned to defendant The Western Pacific Railroad Company all of its properties. Defendants deny the remaining allegations of paragraph V.

VI.

Answering paragraph VI, defendants allege that they are without knowledge or information sufficient to form a belief as to the truth of the allegations contained in that paragraph and on that ground they deny them, except that defendants admit that the stock of defendant The Western Pacific Railroad Company was found to be without value in the reorganization proceeding.

VII.

(a) Answering the allegations of subparagraph (a) of paragraph VII, defendants allege that they are without knowledge or information sufficient to form a belief as to the truth of those allegations and on that ground they deny them, except that defendants admit that defendant The Western Pacific Railroad Company prior to reorganization was indebted to the A. C. James Company in the amount of \$4,999,800, which indebtedness was secured by general and refunding mortgage bonds of defendant The Western Pacific Railroad Company in the face amount of \$4,249,500 and defendants further admit that Robert E. Coulson was a mem-

ber of the reorganization committee appointed by this Court in the reorganization proceeding.

(b) Answering the allegations of subparagraph (b) of paragraph VII, defendants allege that they are without knowledge or information sufficient to form a belief as to the truth of those allegations and on that ground they deny them, except that defendants admit that pursuant to the plan of reorganization, bonds and stock of the reorganized company were issued to the A. C. James Company and that as of April 22, 1946, the James Foundation of New York, Inc., was the largest single stockholder of defendant, The Western Pacific Railroad Company. Defendants deny that the Foundation now dominates or controls defendant, The Western Pacific Railroad Company, or that it has ever done so.

(c) Answering the allegations of subparagraph (c) of paragraph VII, defendants admit that Robert E. Coulson and William W. Carman are officers of the James Foundation of New York, Inc.; that Robert E. Coulson was at one time a director of plaintiff corporation; that Robert E. Coulson was a member of the reorganization committee and signed the agreement of November 22, 1943; that Robert E. Coulson is now and since the reorganization has been a director of defendant, The Western Pacific Railroad Company; that Robert E. Coulson is now and for some time has been a partner in the law firm of Whitman, Ransom, Coulson & Goetz, 40 Wall Street, New York

City, the firm representing The Western Realty Company in this litigation; that the Reorganization Trustees participated in engaging James K. Polk of that firm as tax counsel to represent the affiliated group of corporations; that William W. Carman executed the agreement of November 22, 1943; that William W. Carman was at one time a director of plaintiff corporation; that Michael J. Curry has been and now is an officer and director of plaintiff corporation; that Michael J. Curry executed the agreement of November 22, 1943; that Mary C. Valouch has been and now is an officer of plaintiff corporation; that Mary C. Valouch is an employee of the firm of Whitman, Ransom, Coulson & Goetz; that Thomas M. Schumacher has been and now is a director of plaintiff corporation and was at one time its president; that Thomas M. Schumacher was one of the Reorganization Trustees in the reorganization proceeding. Defendants deny the remaining allegations of subparagraph (c).

(d) Defendants deny the allegations of subparagraph (d) of paragraph VII.

VIII.

(a) Defendants deny the allegations of subparagraph (a) of paragraph VIII.

(b) Answering the allegations of subparagraph (b) of paragraph VIII, defendants admit that the consolidated returns for the years 1943 and 1944 and the refund claim for 1942 were filed

after October 11, 1943, and after November 22, 1943; that the stock of defendant, The Western Pacific Railroad Company, was transferred to the reorganization committee on April 30, 1944; that plaintiff corporation had no taxable income for 1942, 1943 and 1944. Defendants deny the remaining allegations of subparagraph (b).

(c) Defendants deny the allegations of subparagraph (c) of paragraph VIII.

(d) Defendants deny the allegations of subparagraph (d) of paragraph VIII, except that defendants admit and allege that any refund which might have been made pursuant to the refund claim, and any fund in any way attributable to that claim, belongs to defendant, The Western Pacific Railroad Company.

IX.

Answering the allegations of paragraph IX, defendants allege that they are without knowledge or information sufficient to form a belief as to the truth of those allegations and for that reason they deny them, except that defendants admit that until this action was filed plaintiff corporation never asserted the claim which is the subject of this action and except that defendants specifically deny that defendants or any one of them dominate or control plaintiff corporation and defendants further deny that this action was commenced for or on behalf of or at the instance of the defendants, or any of them, or that this action is in any respect collusive.

X.

Answering the allegations of paragraph I of the second cause of action, defendants refer to paragraphs I to IX, inclusive, of this answer and by this reference incorporate into this paragraph the allegations there appearing.

XI.

Answering the allegations of paragraph II of the second cause of action, defendants admit that defendant, The Western Pacific Railroad Company, was in reorganization from August 2, 1935, to March 28, 1946, and that the final order in the reorganization proceeding was entered March 28, 1946. Defendants deny the remaining allegations of paragraph II.

XII.

For a further and separate defense to the complaint in intervention, defendants allege that said complaint and each cause of action therein fails to state a claim against defendants, or any of them, upon which relief can be granted.

XIII.

For a further and separate defense to the second cause of action of the complaint in intervention, defendants allege that this court, without bankruptcy jurisdiction, has no jurisdiction over the subject matter of the second cause of action.

XIV.

For a further and separate defense to the complaint in intervention, defendants allege that the

issues framed by said complaint are not within the scope of this action and are not properly the subject of a complaint in intervention.

XV.

For a further and separate defense to the complaint in intervention defendants allege that said complaint does not name as defendants indispensable and necessary parties.

XVI.

(a) During the years 1942 and 1943 and the first four calendar months of the year 1944, the plaintiff and the defendants, including the defendant, Deep Creek Railroad Company, which was in the process of liquidation in the years 1943 and 1944, were an affiliated group of corporations within the meaning of the Internal Revenue Code. Plaintiff was at all said times the parent corporation of said group and filed income and excess profits tax returns on a consolidated basis for said group for the said years 1942 and 1943. In the year 1945, plaintiff filed an income and excess profits tax return for the year 1944 and included in said return the income of the other members of said affiliated group for the first four months of 1944. The said consolidated return for the year 1942 reported income and excess profits tax payable by the affiliated group in the sum of \$4,201,821.54, and the aforesaid returns for the years 1943 and 1944 reported no taxable income. On March 9, 1945, the plaintiff filed with the Federal Collector

of Internal Revenue in the Second District of New York, a claim for refund of the sum of \$4,201,821.54 theretofore paid as income and excess profits taxes for 1942, together with the interest thereon. The whole of said last mentioned amount of tax was paid in 1943 by plaintiff with funds supplied to plaintiff for that purpose by the Reorganization Trustees of defendant, The Western Pacific Railroad Company. Thereafter and in the year 1943, certain of the defendants herein paid or credited to said Reorganization Trustees their respective portions of said tax, so that the net amounts of said tax borne and paid by the parties of this suit were as follows:

Plaintiff	\$	00.00
Defendant The Western Pacific Railroad Company.....		4,144,828.87
Defendant Sacramento Northern Railway		2,847.58
Defendant Tidewater Southern Railway Company		53,608.94
Defendant The Western Realty Company.....		00.00
Defendant Deep Creek Railroad Co.		00.00
Defendant Standard Realty and Development Company.....		00.00
Defendant Delta Finance Co., Ltd....		536.15
		<hr/>
Total	\$	4,201,821.54

On or about September 1, 1947, the tax liability of the affiliated group to the Federal Government for the years 1942, 1943 and 1944 was settled by an agreement whereunder the 1942 refund claim was denied and the 1943 and 1944 returns were accepted as filed. This settlement is the subject of a stipulation filed in this action on September 5, 1947. In so far as that stipulation requires that this action be determined as though the 1942 refund had been allowed in part, defendants allege that defendant, The Western Pacific Railroad Company, is entitled to the whole of said sum together with all interest thereon, and to the whole amount refunded. Defendant, The Western Pacific Railroad Company, will credit or pay to the defendants Sacramento Northern Railway, Tidewater Southern Railway Company, and Delta Finance Co., Ltd., their respective proportions thereof, and said three last named defendants look to defendant, The Western Pacific Railroad Company, for such credit or payment. None of the parties to the above entitled cause, other than the defendant, The Western Pacific Railroad Company, and said last named three defendants, paid or contributed any sum or thing of value to the payment of said tax or any part thereof, and none of said parties other than the defendant, The Western Pacific Railroad Company, has any right, title, interest or claim, at law or in equity, in or to said refund claim or the amount refundable thereunder or any part thereof. Under and by virtue of the Internal Revenue Code

and the regulations thereunder providing for and relating to consolidated returns for affiliated corporations, the tax liability of said affiliated group for Federal income and excess profits taxes was required to be, and was, determined upon the basis of the taxable net income of the said group as a unit. Provision for the allocation to the respective members of such group of their proportion of the tax so determined to be payable was lawful and proper, and the whole of said tax for 1942 was allocated to the defendant, The Western Pacific Railroad Company, and the three other defendants aforesaid, as above set forth, but no right, title, interest or claim was created or arose, or could be created or arise, on the part of any member of said affiliated group against any other member thereof, by virtue of said consolidated returns or any thereof, or by virtue of the individual deductible losses or taxable gains of such members, or otherwise, for any sum in excess of the portion of the tax actually paid or payable by the member making such claim. In the year 1943, plaintiff and other members of said group incurred deductible losses in a total amount sufficient to eliminate all taxable income for the affiliated group for 1943 and to provide unused credit balances to carry back to 1942 and carry forward to 1944 sufficient to establish no taxable income for the years 1942 and 1944, and in said federal tax returns for 1943 and 1944 plaintiff reported said losses and said carry-back and carry-forward por-

tions thereof, and the aforesaid claim for refund of the 1942 taxes referred to the said carry-back. The major portion of the aforesaid deductible losses incurred in the year 1943 was the loss of plaintiff arising from the fact that the stock of the defendant, The Western Pacific Railroad Company, held by plaintiff became worthless in said year. In and by reporting said loss in said returns for 1943 and 1944, and in and by referring to the same in filing said claim for refund, plaintiff suffered no detriment, loss, cost or expense and furnished no legal or equitable consideration or contribution to the members of the affiliated group or to any of them.

(b) By the terms of the Internal Revenue Code and the regulations thereunder, any amount refundable under said refund claim is and was payable by the United States to the plaintiff as collecting agent for the member of said group, namely, defendant, The Western Pacific Railroad Company, which originally provided the moneys for payment of the tax. Said claim was filed and was made for the use and benefit of said defendant as the member of said affiliated group which provided the moneys for payment of the entire tax for the group. The other defendants which contributed to the payment of said tax, namely, Sacramento Northern Railway, Tidewater Southern Railway Company, and Delta Finance Co., Ltd., will look to defendant, The Western Pacific Railroad Company, for such credit or payment as may be appropriate.

Plaintiff is not entitled beneficially to the refund of the same or any part thereof or any interest thereon. Neither said claim for refund nor the moneys that are refundable thereunder constitute or are a fund of said affiliated group, or a fund in respect whereof the members of said group may interplead or be interpleaded, but on the contrary said claim was at all times the exclusive right and property of defendant, The Western Pacific Railroad Company, and said defendant is entitled to the whole sum refundable or deemed to be refundable thereunder.

XVII.

Defendant, The Western Pacific Railroad Company, has a reserve fund for contingent tax liabilities in the sum of \$10,100,000, invested in United States Government securities, for the purpose of discharging the liability of said defendant for such federal income and excess profits taxes, if any, as may be imposed upon said defendant for the years 1943 and 1944. Neither the plaintiff nor any member of said affiliated group other than defendant, The Western Pacific Railroad Company, furnished or contributed any money or other thing of value to said fund. Said fund and the securities comprising the same are the exclusive property of the defendant, The Western Pacific Railroad Company, and the said fund is held by said defendant to provide for the payment of its own taxes, if any are payable by it, and not for the benefit, advantage, use or behoof of plaintiff or any other

member of said group. Neither said fund nor any part thereof is a fund of said affiliated group, or a fund in respect whereof the members of said group may interplead or be interpleaded, and neither plaintiff nor any member of said affiliated group other than the defendant, The Western Pacific Railroad Company, has any right, title, interest or claim in or to said fund, or in or to any part thereof, at law or in equity.

XVIII.

It was plaintiff's duty under the Internal Revenue Code and regulations to make and file income and excess profits tax returns for the years 1942, 1943 and 1944. In and by making and filing said income and excess profits tax returns for the years 1942 and 1943 and 1944, plaintiff performed its said duty in accordance with the requirements of the Code and regulations. Plaintiff as a separate corporation had no income or excess profits tax liability on either a separate or a consolidated basis for 1942, 1943 and 1944 and paid no tax for any of said years. In and by filing said returns plaintiff furnished no consideration or contribution whatsoever to other members of said affiliated group, or any of them, and suffered no detriment, loss, cost or expense for itself or for said members or any of them, in that its action in filing said returns was performed under a duty imposed by law.

XIX.

In and by filing the said returns for the years 1942, 1943, and 1944, and in and by filing said refund claims, plaintiff acted as the agent and representative of the affiliated group to file such returns and claim for refund, but plaintiff did not therein or thereby gain or acquire any right or claim as against any other member of said group to be paid any sum or sums or receive anything of value for or on account of filing said returns or claim, or for or on account of theoretical taxes not paid or payable by said group or any member thereof, and on the contrary the exaction or receipt by plaintiff from the members of said group or any thereof, of any sum or other thing of value, for or on account of so-called tax savings, to wit, moneys not paid or payable as taxes, by any other member or members of said group, resulting from the filing of consolidated returns, would have been and was and is inequitable, unjust, and unconscionable, and the claims made by plaintiff and by the intervenor in this cause to payment or other compensation for or on account of such tax savings, were and are inequitable, unjust, and unconscionable, in that plaintiff was an agent and fiduciary for the members of said affiliated group in making said returns, and may not lawfully or equitably use or avail of its said agency to obtain or secure a profit or advantage for itself at the expense of other members of said group for whom it was such agent.

XX.

In and by filing the said returns and filing said refund claim, plaintiff acted as the agent and representative designated by the Internal Revenue Code and the regulations thereunder relating to consolidated returns for affiliated groups, but plaintiff did not therein or thereby gain or acquire any right or claim as against any other member or members of said group to be paid any sum or sums or receive anything of value for or on account of filing said returns or claim, or for or on account of taxes not paid or payable by said group or any member thereof, and on the contrary the exaction or receipt by plaintiff or by the intervenors from the members of said group or any thereof, of any sum or other thing of value, for or on account of such filing or said taxes not paid or payable, would have been and was and is illegal, unjust and inequitable, and contrary to the intent and purpose of the Internal Revenue Code and the regulations thereunder, and plaintiff's claims and the claims of the intervenors in this case are illegal, unjust and inequitable, and contrary to the intent and purposes of the Code and said regulations, in that such exaction or receipt and the claims made by plaintiff and by the intervenors in this cause would constitute and be a purchase and sale of deductible tax losses, or exaction of compensation therefor, and a sale of the privilege of filing consolidated returns, contrary to the intent and purpose of the said statutes, and the regulations thereunder.

XXI.

At the time plaintiff filed said consolidated returns for the year 1943, to wit, July 15, 1944, wherein plaintiff reported its said large deductible loss of 1943, plaintiff had an interest in the said affiliated group, in that plaintiff was then entitled, under certain contingencies, to regain the ownership of all the stock of the defendant, The Western Pacific Railroad Company, and plaintiff's act and decision in filing the same was done and taken for the advantage and benefit of plaintiff in that plaintiff's said contingent interest in the stock of said defendant gave to plaintiff an interest in the effect upon the tax liability of said defendant of filing said consolidated returns. In and by reporting said deductible loss in said consolidated return, plaintiff elected to, and became bound to, apply the carry-back portion thereof to the year 1942, and to file a refund claim on account of such carry-back and the aforesaid refund claim was thereafter filed by plaintiff in pursuance of its said election and obligation so to do.

XXII.

Ever since the year 1918 and until April 30, 1944, plaintiff was the parent corporation of and controlled the members of an affiliated group of corporations and determined whether or not consolidated returns should be filed for said group, including itself, and therein and thereby exercised for itself and said group and in the common interests of the members of the group and the interest of

the plaintiff as the sole owner of the ultimate equity in the group the statutory privilege extended by the applicable provisions of The Revenue Acts and Section 141 of the Internal Revenue Code of filing or not filing consolidated returns and elected continuously in favor of consolidated returns and therein and thereby plaintiff elected for itself and the other members of said group and from time to time committed the group for future years to file such consolidated returns. The defendants The Western Pacific Railroad Company and Deep Creek Railroad Company were members of said affiliated group at all of said times and the other defendants herein were members of said group at various times. In and by its said control and elections from time to time plaintiff derived many advantages and benefits in the manner and to the extent intended by the said statutes and regulations, including, among others, the future consequences of such elections, as well as the results and effects in the years of filing the returns, and the various members of said group, including plaintiff, had variously individual incomes and deductible losses taken up in said consolidated returns from year to year. At all said times plaintiff controlled the allocation of the taxes as between the members of said group, and continuously and consistently allocated the group tax for each year between the members of said group, including itself, who had individual taxable incomes in such year, in the proportions that their individual incomes bore to the total of such incomes, ignoring

losses of other members of the group, but plaintiff never charged itself nor claimed credit for itself or charged or claimed credit for any member of said group for or on account of theoretical taxes not payable by the group in consequence of deductible losses suffered or incurred by one or more of its members in years when other members had taxable gains. Neither plaintiff nor the interveners made any claim of that nature against or in favor of any member of the group until the making of the claims stated in its complaint herein, which said claims were not made until long after the said affiliation had been severed and were made at a time when plaintiff had no ownership of or interest in said group or any member thereof. Plaintiff and the interveners as stockholders of plaintiff and all other members of said group became bound by, and agreed to, the said long continued custom and practice of allocating between the members of said group the actual group tax, and no more, and therein and thereby plaintiff waived and relinquished whatsoever right it might otherwise have had to claim as against any member of said group, any other or further allocation, adjustment or claim arising out of the filing of such consolidated returns or the individual taxable gains and deductible losses of the members of said group. By reason of said custom, practice and agreement and by reason of the advantages and benefits received by plaintiff from the said exercise of its privilege of filing consolidated returns for said group for all said years, plaintiff's

claims and the claims of the interveners in this suit are unjust, inequitable and unconscionable.

XXIII.

At all times mentioned herein to and including April 30, 1944, plaintiff was the owner and holder of all of the capital stock of defendant The Western Pacific Railroad Company. From August 2, 1935, to December 29, 1944, defendant The Western Pacific Railroad Company was a railroad corporation in reorganization under the provisions of Section 77 of the Bankruptcy Act, in that certain proceeding in the United States District Court for the Northern District of California, Southern Division, entitled "In the Matter of The Western Pacific Railroad Company," No. 26591-S in the files of said Court, and the title to and possession of all of its properties were at all times from September 23, 1935, to December 29, 1944, held by T. M. Schumacher and Sidney M. Ehrman, as the Reorganization Trustees appointed by said court. Said defendant The Western Pacific Railroad Company was reorganized in said proceeding under a Plan of Reorganization filed by the Interstate Commerce Commission June 21, 1939, which said Plan of Reorganization was finally confirmed by said Court by its order in said proceeding made October 11, 1943. In and by said Plan of Reorganization as finally confirmed October 11, 1943, it as determined that the stock of said defendant held by plaintiff herein, being all of the preferred and common capi-

tal stock of said defendant, was without equity or value. Under and pursuant to said Plan of Reorganization and the order of said Court in said proceeding made November 27, 1944, and at 12:01 A.M., on December 29, 1944, said Trustees returned and transferred to the said reorganized corporation, defendant The Western Pacific Railroad Company, all the business, assets and property, of every kind and description held by said Trustees in said bankruptcy proceeding, free and clear of all claims other than such claims as were preserved under the said Plan of Reorganization and were not limited or discharged by the orders of said Court.

XXIV.

In and by their claims against the defendant The Western Pacific Railroad Company and against and in respect of the said reserve and the said refund claim belonging to the defendant The Western Pacific Railroad Company, plaintiff and the interveners seek to establish and enforce liens senior to the liens of those claimants in said reorganization proceeding whose liens were found to have equity and value and were preserved and provided for in the said Plan of Reorganization, and plaintiff and the interveners seek thereby to gain a preference over such claimants. The entire business, assets and properties of said reorganized company were returned and transferred to it by said Trustees pursuant to said Plan and the orders of said Court, subject only to the claims so preserved. In and

by said Plan of Reorganization all claims junior to the claims of First Mortgage Bondholders and General and Refunding Mortgage Bondholders of said defendant The Western Pacific Railroad Company were found and determined to be without equity or value, and the claims of said bondholders were preserved, and were paid and discharged under said Plan in common stock, and other securities, of the said reorganized company, so that the said bondholders became the owners of the entire common stock of the reorganized company. Plaintiff's aforesaid claims and the claims of the interveners in this cause and each of them are unjust, inequitable and unconscionable in this, that the aforesaid deductible loss incurred by plaintiff, and the filing of said federal tax returns and refund claim reporting said loss, furnish no just or equitable ground or reason for giving or granting to plaintiff a preference over said prior claimants, to wit said bondholders, as to all or any part of said reserve fund or said refund claim or any other assets or property of said reorganized company, but said claims of plaintiff and the interveners cannot now be recognized or allowed in any manner or to any extent without thereby granting such inequitable preference.

XXV.

Each and all the claims of plaintiff and the interveners in and to said reserve fund, or any portion thereof, and in and to said refund claim, or the amount refundable thereunder, are unjust,

inequitable, and unconscionable in all the respects hereinafter in this paragraph averred or mentioned. Said claims and each of them arose and could have been presented to the said Bankruptcy Court more than two years before the commencement of this action. Plaintiff was a party to said reorganization proceeding and had personal notice of all of the proceedings in the Bankruptcy Court and before the Interstate Commerce Commission in respect of the business, assets and properties of the defendant The Western Pacific Railroad Company and the Plan of Reorganization thereof. The interveners, at any time after they purchased their stock interest in plaintiff, could have asked leave of court to be made parties to the reorganization. No such leave was requested. Plaintiff and the interveners stood by and wholly failed and neglected to present their claims, or any thereof, to the said Court or to said Commission or to the said Reorganization Trustees or to the defendant The Western Pacific Railroad Company, and wholly failed to notify the said Court, Commission, Trustees or defendant company thereof prior to the effectuation and consummation of said Plan of Reorganization, and permitted the said Plan to be effectuated and consummated without presenting or giving notice of said claims to said Court, Commission, Trustees or defendant company so that said Plan of Reorganization was effectuated and consummated by said Trustees pursuant to said Plan and the orders of said Court and Commission, and all parties in interest under

said Plan accepted and received the new securities and the other provisions made for them under said Plan, without notice of plaintiff's said claims, or the claims of the interveners or any thereof. Plaintiff and the interveners further stood by and wholly failed and neglected to present claims, or any thereof, to the said Court, Trustees and defendant company, or any thereof, and wholly failed to notify them or any of them of such claims or any thereof, prior to the final settlement of the accounts of said Trustees by said Court, and prior to the termination of said reorganization proceedings, and permitted said accounts to be settled and said proceedings to be terminated without giving notice of said claims or any thereof, or presenting the same or any thereof, and all parties in interest participated in the said proceedings, and said accounts were settled and allowed, and said proceedings were terminated, without any party to said proceedings having notice of said claims or any thereof. In and by the neglect and conduct of plaintiff and the interveners aforesaid plaintiff and the interveners were guilty of laches and the said claims and each and all thereof became and are stale and inequitable, and barred by the said laches and inequitable conduct and neglect. These defendants refer to the averments of the preceding paragraphs of this answer in connection with and as stating further grounds for their defense that plaintiff's claims and the claims of the interveners are stale and barred by laches.

XXVI.

The rights of action set forth in the complaint in intervention in respect of, or pertaining to, that portion of the reserve fund created by said court order, to wit, \$7,100,000 did not accrue within two years next before the commencement of this action. The rights of action set forth in said complaint in respect of the remainder of said reserve fund, to wit, \$3,000,000 and in respect of the said refund claim, to wit, the claim for refund of \$4,201,821.54 taxes paid for the year 1942, did not accrue within two years next before the commencement of this action.

XXVII.

Said Bankruptcy Court on March 28, 1946, made its Final Order in said reorganization proceeding terminating said proceeding, subject only to the reservations of jurisdiction made and referred to in said order, and in and by said order said Court permanently restrained and enjoined all persons from instituting, prosecuting or pursuing claims against said defendant The Western Pacific Railroad Company, or against any of the assets or property of said defendant, on account of any right, claim or interest which such person might have had in, to or against said defendant, or any of its assets or properties, on or before December 28, 1944 (except as specifically provided for or permitted by prior order of said Court). In and by said Final Order plaintiff and the interveners were and are forever restrained and enjoined from instituting

or prosecuting this cause as against the defendant The Western Pacific Railroad Company and from instituting or prosecuting any action or proceeding to establish or enforce the claims and each thereof against said defendant which are set forth in their complaints herein.

XXVIII.

In and by said Plan of Reorganization and the said Orders of said Court, and each of them, plaintiff and the interveners were and are forever barred and foreclosed from claiming as against the defendant The Western Pacific Railroad Company all or any part of the aforesaid claim for refund of taxes paid by said Trustees in the sum of \$4,201,-821.54, and forever barred and foreclosed from claiming all or any part of the said refund; and any sum payable upon said refund claim, including interest thereon, became and was and is the property and asset of defendant The Western Pacific Railroad Company, free and clear of all claims and demands of plaintiff or the interveners.

XXIX.

In and by said Plan of Reorganization and the said Orders of said Court, and each of them plaintiff and all parties to this action other than defendant, The Western Pacific Railroad Company, were and are forever barred and foreclosed from claiming all or any part of said reserve fund of \$10,100,-000 and forever barred and foreclosed from claiming against said defendant any sum or contribution

whatsoever on account of the so-called tax savings, to wit, the nonexistence of taxable net income, reported by the said returns filed for the years 1943 and 1944, and the entire business, assets and property returned and transferred by said Reorganization Trustees to said defendant were in and by said Plan and Orders returned and transferred to said defendant free and clear of all such claims of plaintiff and the interveners and the other members of said affiliated group or any of them. In and by said Orders of said Court and the said Plan of Reorganization and each of them, each and every, all and singular, the claims of plaintiff and the interveners in this cause against the defendant, The Western Pacific Railroad Company, were and are forever barred and foreclosed.

XXX.

Said Bankruptcy Court on March 3, 1944, made its order authorizing and directing the said Trustees to establish a reserve fund for contingent tax liabilities in the amount of \$7,100,000 for the sole and exclusive purpose of providing for the payment of federal income and excess profits taxes for the year 1943 in the event the same should become payable by said Trustees or by the reorganized company, defendant, The Western Pacific Railroad Company. In and by said Order, said reserve fund became and was, and is, a fund belonging exclusively to the reorganized company, defendant, The Western Pacific Railroad Company, and may not be subjected to the claims of the interveners or the

claims of the other members of the said affiliated group or any of them. Said reserve fund created by said Court order is a part of the reserve fund of \$10,100,000 mentioned in the complaint in intervention. The remainder of said reserve fund, to wit, \$3,000,000, was created by resolution of the Board of Directors of the reorganized company, The Western Pacific Railroad Company adopted March 26, 1945, for increasing said reserve fund held for said purposes, exclusively, to the sum of \$10,100,000. Neither plaintiff nor the interveners, nor any other member of the affiliated group, other than defendant, The Western Pacific Railroad Company, has ever contributed anything to said reserve fund and neither plaintiff nor the interveners nor any of the said other members of said group have any right, title, interest or claim in or to said reserve fund, or in or to any portion thereof at law or in equity.

XXXI.

At all times from August 2, 1935, until March 28, 1946, the rights of plaintiff against the defendant, The Western Pacific Railroad Company, and the Reorganization Trustees were before this Court for adjudication in the reorganization proceeding. Plaintiff and the interveners could have obtained in that proceeding an express adjudication of the claims which are presented in this action. Their failure to do so renders those claims forever barred under the principles of *res judicata*.

XXXII.

At no time before the institution of this action did plaintiff or the interveners in any way assert the claims which are the subject of this action. If they had asserted those claims promptly, the defendant, The Western Pacific Railroad Company, the Reorganization Trustees and all parties to the reorganization proceeding could have applied to this Court, conducting the reorganization, for an order directing plaintiff to file the consolidated returns for 1942, 1943 and 1944 and the refund claim for 1942 without any charge by the plaintiff or the interveners or any compensation to them. If that application had been denied, the Reorganization Trustees and the defendants could then have elected to file separate income tax returns and to avail themselves of the rights, privileges, options and advantages belonging to persons who pay taxes to the Federal Government. The Reorganization Trustees and the defendants could have taken steps to improve their tax position by, among other things, taking advantage of the tax benefit which would arise from a determination of the insolvency of defendant Sacramento Northern Railway. The Reorganization Trustees and the defendants have in reliance upon the silence of plaintiff and the interveners changed their position to their detriment. Plaintiff and the interveners are therefore estopped from asserting their claims. They are also estopped from maintaining in this action a position inconsistent with the position plaintiff maintained in the

reorganization proceeding. Plaintiff and the interveners are further precluded from maintaining their claims by reason of the fact that the concurrence of each member of the affiliated group was necessary in order that consolidated returns might be filed. The claims of plaintiff and of the interveners to the alleged tax saving are therefore unjust and unconscionable because plaintiff's claim to that alleged saving could in no event be better than the claim of each of the defendants.

XXXIII.

Defendants are informed and believe and upon information and belief allege that the interveners are foreclosed from asserting the claims which are the subject of complaint in intervention by reason of the fact that the persons from whom they purchased their stock in the plaintiff corporation are estopped from asserting those claims and by reason of the further fact that the interveners are not qualified to maintain a stockholders' suit on behalf of plaintiff corporation.

XXXIV.

Defendants allege that by reason of the circumstances set forth in this answer, the claims of plaintiff and the interveners are barred by each of the following affirmative defenses: Discharge in bankruptcy pursuant to Section 77, of the Bankruptcy Act, res judicata, estoppel, laches, failure of consideration, illegality, statute of limitations and waiver.

XXXV.

Defendants deny each of the allegations of the complaint in intervention which is not specifically admitted in this answer.

Wherefore, defendants pray for the order, judgment and decree of this Honorable Court:

1. Declaring and determining that defendant, The Western Pacific Railroad Company, is the sole owner of and is exclusively entitled to said reserve fund and said refund claim and all sums refundable thereunder and quieting the right and title of said defendant therein and thereto against the claims of plaintiff and the interveners and all other parties to this cause and restraining and enjoining plaintiff and the interveners and all other parties to this cause other than defendant, The Western Pacific Railroad Company, from instituting or prosecuting claims thereto.

2. Declaring and determining that neither plaintiff nor the interveners have any rights or claims against these defendants or any of them for or on account of any matter or thing averred in the complaint in intervention.

3. For defendants' costs of suit herein and such

other and further relief as may be meet and equitable in the premises.

Dated: November 5, 1947.

THE WESTERN PACIFIC RAILROAD COMPANY,

SACRAMENTO NORTHERN RAILWAY,

TIDEWATER SOUTHERN RAILWAY COMPANY,

DELTA FINANCE CO., LTD.,

STANDARD REALTY AND DEVELOPMENT COMPANY.

By /s/ ALLAN P. MATTHEW,

JAMES D. ADAMS,

ROBERT L. LIPMAN,

BURNHAM ENERSEN,

Their Attorneys.

Receipt of copy attached.

Affidavit of Service by Mail attached.

[Endorsed]: Filed November 5, 1947.

[Title of District Court and Cause.]

SUPPLEMENTAL BILL OF COMPLAINT

The Western Pacific Railroad Corporation, the plaintiff herein by leave of Court first had and obtained, files this, its Supplemental Bill of Complaint, and respectfully shows and alleges as follows:

First: That at the time of the filing of the Bill of Complaint herein the consolidated excess profits and income tax returns of the plaintiff and its affiliated companies for the year 1942 and 1943 and the period January 1, 1944, to April 30, 1944 (hereinafter sometimes called "the three tax periods"), on which last named date affiliation ended, had not been finally audited and accepted by the Commissioner of Internal Revenue and the claim or cause of action therein set forth and alleged by plaintiff against all or any of its former affiliated companies, defendants herein, was inchoate and unliquidated; that sometime prior to the filing of the Bill of Complaint and prior to March 28, 1946, on which last named date the Bankruptcy Proceeding was terminated with certain reservations of jurisdiction, James K. Polk, tax counsel with the firm of Whitman, Ransom, Coulson & Goetz, undertaking and purporting at the instance of defendants to represent the separate as well as the common interests of plaintiff as well as of defendants entered into negotiations with the Commissioner of Internal Revenue for a settlement of their tax liabilities for the three tax periods under which

the Treasury of the United States (a) would accept as final the consolidated income and excess profits tax returns of the Affiliated Group for the three tax periods (b) allow in reduction of defendants' taxable income and profits the losses and credits that had accrued to plaintiff and (c) retain the tax payment made thereunder, being the sum of \$4,201,821.54 paid for 1942, and the plaintiff would withdraw or consent to the rejection of its then pending claim for a refund of said payment of \$4,201,821.54, together with interest thereon from the date of payment; and that on February 11, 1947, the aforementioned negotiations for a settlement of said tax liabilities had so far progressed toward a final and definitive agreement as to justify the transmission of a formal written offer of settlement.

Second: That on February 11, 1947, James K. Polk, one of the Attorney-in-Fact representing the plaintiff and its former affiliated companies (hereinafter called the Affiliated Group) and a member of the firm of Whitman, Ransom, Coulson & Goetz, tax counsel for the Affiliated Group, transmitted to the Commissioner of Internal Revenue a formal written offer of settlement which in terms was made on behalf of the plaintiff and its former affiliated companies, a true copy of which communication is hereto annexed and made a part hereof, marked Exhibit A.

Third: That the plaintiff had not been informed in advance of the transmission of said offer of settlement, Exhibit A, nor of the pendency of the

prior negotiations leading up thereto, nor of the probable realization of substantial tax savings, of which the plaintiff would be beneficiary, until many months after the transmission of Exhibit A when a copy thereof was furnished to the plaintiff by said James K. Polk of the firm of Whitman, Ransom, Coulson & Goetz with a request for approval and ratification of the action so taken on behalf of the Affiliated Group by him as their Attorney-in-Fact.

Fourth: That on August 13, 1947, the Board of Directors of the plaintiff approved and ratified the transmission of said offer subject, however, to the condition that the defendant, The Western Pacific Railroad Company, enter into a stipulation (afterwards approved by this Court) to be signed by the attorneys for the plaintiff and for the defendants (and afterwards so signed pursuant to the direction of this Court), a copy of which stipulation is hereto annexed and made a part hereof, marked Exhibit B.

Fifth: That on August 13, 1947, the Deputy Commissioner of Internal Revenue on behalf of the Treasury of the United States accepted the then pending offer of settlement in a communication dated on said date and addressed to the plaintiff and its affiliated companies, a true copy of which is hereto annexed and made a part hereof, marked Exhibit C.

Sixth: That thereafter, on August 26, 1947, the Deputy Commissioner of Internal Revenue in ac-

cordance with the terms of settlement previously accepted by him on behalf of the Treasury of the United States transmitted a communication dated on said date and addressed to the plaintiff which rejected the pending claim of the plaintiff for a refund of the taxes provided for by the Trustees of the defendant, The Western Pacific Railroad Company, and paid by the plaintiff as parent of the Affiliated Group for the year 1942 in the amount of \$4,201,821.54, a true copy of which communication is hereto annexed and made a part hereof, marked Exhibit D.

Seventh: That on said last mentioned date the claim of the plaintiff against defendants to account for the benefit and enrichment claimed by defendants for themselves through the utilization of plaintiff's deductible losses and credits in effecting tax savings became definitive and justiciable in an amount susceptible of mathematical calculation and thereupon the plaintiff employed the firm of Lybrand, Ross Bros. & Montgomery, Certified Public Accountants, to determine by a calculation the excess profits and income tax liabilities of the defendant, The Western Pacific Railroad Company, and each of the other defendants for the three tax periods on a separate or individual basis without the benefit of the authorized deductions and credits belonging to the plaintiff; and there here follows the summary made by said firm of Accountants of their computation for the three tax periods for each of said affiliated companies, which summary and computation the plaintiff hereby alleges to be correct:

	Year 1942	Year 1943	Period January 1 to April 30, 1944	Total
The Western Pacific Railroad Corporation:				
Excess profits tax	None	None	None	None
Income tax	None	None	None	
The Western Pacific Railroad Company:				
Excess profits tax	\$4,825,020.69	\$10,614,539.48	\$1,397,379.67	\$21,618,254.45
Income tax	2,090,672.67	2,133,230.11	557,411.83	
Total.....	<u>\$6,915,693.36</u>	<u>\$12,747,769.59</u>	<u>\$1,954,791.50</u>	
Sacramento Northern Railway:				
Excess profits tax	None	None	None	None
Income tax	None	None	None	
Tidewater Southern Railway Company:				
Excess profits tax	None	None	None	78,210.92
Income tax	\$ 55,907.03	\$ 19,843.16	\$ 2,460.73	
Total.....	<u>\$ 55,907.03</u>	<u>\$ 19,843.16</u>	<u>\$ 2,460.73</u>	

	Year 1942	Year 1943	Period January 1 to April 30, 1944	Total
Deep Creek Railroad Company:				
Excess profits tax	None	None	None	None
Income tax	None	None	None	None
The Western Realty Company:				
Excess profits tax	None	None	None	None
Income tax	\$ 6,168.43	\$ 4,562.82	\$ 507.75	
Total.....	\$ 6,168.43	\$ 4,562.82	\$ 507.75	11,239.00
Standard Realty and Development Company:				
Excess profits tax	None	None	None	None
Income tax	None	\$ 1,060.25	\$ 40.39	1,100.64
Total.....	None	\$ 1,060.25	\$ 40.39	
Delta Finance Company, Ltd.:				
Excess profits tax	\$ 910.57	None	None	None
Income tax	2,265.06	906.15	None	None
Total.....	\$ 3,175.63	\$ 906.15	None	4,081.78
				<u>\$21,712,886.79</u>

That, as heretofore alleged, there was paid, in respect to the tax liability of the Affiliated Group for the year 1942 the sum of \$4,201,821.54 the right to recover which upon claim for refund inured to plaintiff; that no other or additional payments were made to the Collector of Internal Revenue by the Affiliated Group; that, under the settlement hereinabove referred to, the said sum of \$4,201,821.54 was retained by the Treasury of the United States as representing full payment of the tax liability of the defendants for the three tax periods; that by reason solely of the plaintiff's surrender to defendants at their request of its separate right to the exclusive utilization of the heavy losses sustained by and credits belonging to the plaintiff, and of plaintiff's joinder at defendants request in the filing of consolidated returns of tax with them and consequent assumption of consolidated return liabilities and disabilities the acceptance of the proposed settlement by the Commissioner based upon recognition of plaintiff's losses and credits affected a net tax savings by defendants for the three tax periods amounting to the difference between the aggregate excess profits and income tax liabilities, which defendants had incurred and would otherwise have had to pay, as shown in the foregoing summary, amounting to \$21,712,886.79 and the sum accepted by the Government in said settlement; that said savings, retained and now in the possession of the defendants aggregate \$17,511,065.25.

Eighth: That the Internal Revenue Code dating back as early as the Revenue Act of 1917 has con-

tinuously provided for the filing of tax returns on a consolidated basis by closely affiliated corporations, in some periods the filing of such returns being mandatory, in others optional; in some periods by railroad companies only; in other periods (including the three tax periods in which the foregoing tax savings were effected) by corporations generally; but at no time has Congress made any express provision for the allocation to one or more members of an affiliated group for tax savings or benefits resulting from the filing of such returns on a consolidated basis.

Under the statutes of the United States and the regulations of the Treasury Department with regard to the filing of consolidated income and excess profits tax returns the parent is created the sole agent and representative of the group and the group is regarded as an economic unit governed and controlled by the parent corporation which is itself regarded as the taxpayer, each member of the group by joining in a consolidated return being made severally and individually liable to the United States for the entire tax payable for the group under such return, but without statutory provision for allocation of the tax liability among the group members *inter sese*. The reason for the absence of such provision is that the legislation contemplates a parent and subsidiary corporation relationship in which the parent is a proprietor entirely in control and by reason of its proprietorship accrues to itself the benefit and enrichment flowing from any

tax economies effected through the filing of consolidated income and excess profits tax returns. In the three tax periods in which the aforementioned tax savings were effected the legislative requirement was ownership directly or indirectly by the parent of at least 95% of the capital stock of each of the subsidiary corporations so that in normal circumstances there could not be a substantial diverse interest between the parent and any subsidiary corporation by reason of which an allocation upon principles of equity could become necessary to prevent the loss to the parent of its property interest in the tax savings flowing from utilization of its individual losses and credits in any consolidated income and excess profits tax returns. Since, however, the plaintiff herein lost its proprietary control of the defendant subsidiary corporations, although retaining the right to join with defendants in consolidated returns, prior to the date on which the earliest of the tax returns in question became due, the establishment of its inchoate right to an allocation of the tax benefits arising from the filing of the consolidated returns and the enforcement of such inchoate right upon its becoming definitive by settlement with the Government, requires the intervention of a Court of Equity if plaintiff is not to go remediless.

As is shown by the foregoing summary the defendants for the three tax periods incurred individual liabilities to pay to the Treasury of the United States amounts aggregating \$17,511,065.25

in addition to \$4,201,812.54 originally paid for 1942 as their tax burden in respect of war earnings during the three tax periods which under the policy of the Government implicit in the Revenue Code could not be retained as corporate income except as to a relatively negligible portion thereof. For the defendant, The Western Pacific Railroad Company, and any of the other defendants to be permitted to retain any part of said \$17,511,065.25 derived from their utilization of plaintiff's rights under the Internal Revenue Code to the detriment of plaintiff and to their own monetary advantage and derived from their utilization of plaintiff's losses and credits to the exclusion of plaintiff would be fortuitiously and unjustly to enrich them and would moreover permit them to keep wartime profits not taken by the Government solely because Congress allowed as an offset there against losses suffered by and credits belonging to the plaintiff, such losses and credits being allowed by the Congress solely in order that the plaintiff and its stockholders, as the owners of the enterprise throughout the three tax periods, would benefit through the imposition of tax only on the income, after deduction of losses and allowance of credits of the entire commonly owned enterprise. In other words, the tax saving was produced by losses suffered by and credits belonging to the plaintiff and can be justified only because throughout the three tax periods the plaintiff and defendants were affiliated and under the same common ownership. It was the plaintiff

and its stockholders who were intended to be benefited by the provisions of the Internal Revenue Code permitting affiliated corporations under common ownership to file consolidated returns and combine their income and losses and credits. To allow the defendants to keep the tax saving would be inconsistent with the basic objective of Congress and would distort the purpose of Congress in allowing such losses and credits as deductions in consolidated returns.

On the other hand, to allocate the abated taxes amounting to \$17,511,065.25 to the plaintiff in mitigation of its losses would be to carry out the purpose of Congress in permitting the filing of consolidated income and excess profits tax returns, and to the extent of such mitigation of the plaintiff's losses there will be relief from a forfeiture which equity abhors and by the same judicial action there will be the avoidance of an unjust enrichment of defendants which would offend basic equitable principles and shock the conscience of this Court.

The plaintiff invokes the rule fundamental in the interpretation of all Congressional legislation that where one interpretation leads to unjust, unreasonable and improper results and another interpretation equally admissible leads to a result which conforms to a just, reasonable and defensible legislative intent the latter interpretation is imperative.

Ninth: That during the three taxable periods the plaintiff had no taxable income and it sustained losses of \$73,113,079.01 which it had the right

to carry back to the years 1941 and 1942 and to carry forward to the years 1944 and 1945 as an offset against any taxable income for such years. During the three tax periods plaintiff also had large excess profits credits and credit carry-overs and carry-backs which it could utilize to offset any future excess profits it might have. The defendants had large taxable net incomes during each of the three tax periods as follows:

	1942	1943	Jan.-Apr. 1944
Western Pacific Railroad Co.	\$10,806,257.38	\$18,191,914.49	\$2,975,142.13
Sacramento Northern Railway	7,424.36	129,242.17	(192,955.89)
Tidewater Southern Railway	139,767.58	49,704.07	9,484.16
Deep Creek Railroad Co.	None	None	None
Western Realty Co.	(3,612.17)	(595.64)	1,197.67
Standard Realty & Development Co.	None	11,479.88	161.58
Delta Finance Co.	1,397.67	3,624.60	(157.66)

on which as separate taxpayers they incurred income and excess profits tax liabilities in an amount aggregating not less than \$21,712,886.79.

The plaintiff and the defendants, as affiliated corporations, had a right to file consolidated income and excess profits tax returns during the three tax periods the effect of which would be to consolidate the net incomes and losses and credits of the group with taxes imposed only on the resulting consolidated net income and consolidated excess profits net income and such filing of consolidated income and excess profits tax returns would eliminate all or substantially all of the separate tax liabilities of

the defendants. In the ordinary case of filing consolidated returns any consequent benefit would inure to the common parent through its proprietary interest, but since the plaintiff herein lost its proprietary interest in and managerial control of the defendants prior to the filing of the consolidated income and excess profits tax returns and prior to the settlement with the Government of the tax liability for the three taxable periods, the benefits could no longer inure to it unless the defendants are required to account nor could plaintiff alone bring about the filing of consolidated returns. Unless it receive the benefit resulting to the Affiliated Group from filing consolidated returns, the plaintiff could derive nothing but detriment from joining in consolidated returns; the plaintiff made itself jointly and severally liable for any tax liability of the group by joining in the consolidated income and excess profits tax returns and it deprived itself of the valuable right to use for its own exclusive benefit its own excess profits credits and net operating losses by carrying forward such credits and losses against future income it might have during the taxable periods in the years 1944 and 1945. The plaintiff had the right to file separate returns for the three tax periods and thus avoid the liabilities and the detriment to its individual interest entailed by joining in the consolidated income and excess profits tax returns. If the plaintiff had elected to file separate returns during the three tax periods the income and excess profits tax liability of the defendants which they would in such event

have been required to discharge by cash payment would have been not less than \$21,712,886.79.

The plaintiff had no right or power as parent corporation to cause the defendants to consent to the filing of consolidated income and excess profits tax returns because of the reorganization proceedings. At the special instance and request of the defendants and the Trustees in the reorganization proceedings acting for the defendants the plaintiff, however, consented to the filing on its behalf of consolidated income and excess profits tax returns with defendants for each of the three tax periods and thereby at the Trustees and defendants special instance and request surrendered and transferred to defendants its right to utilize for its own exclusive benefit the losses of \$73,113,079.01 and its excess profits credit and the defendants used such rights to their great benefit and advantage to discharge their federal income and excess profits tax liabilities for the said periods. The benefit conferred upon the defendants by the discharge of its tax liability at its request amounted to \$17,511,065.25.

The defendants are obligated in equity and good conscience to account for and pay to the plaintiff the tax saving in the amount of \$17,511,065.25 held by the defendants without right and solely as constructive trustees for the plaintiff.

Tenth: The defendants or said Trustees for the defendants presented the consolidated income and excess profits tax returns for signature to the plaintiff for each of the three tax periods through James K. Polk, tax counsel with the firm of Whitman,

Ransom, Coulson & Goetz which firm of attorneys had been counsel for both plaintiff and defendants prior to the reorganization, and for the Trustees in the reorganization. The same firm of attorneys were also counsel for the James Foundation of New York, Inc., which was not merely a stockholder and creditor of the plaintiff but was as well a creditor of the defendant, The Western Pacific Railroad Company, both prior to and during the reorganization. As a consequence of the reorganization and of heavy purchases of securities of said defendant during the progress of the reorganization the James Foundation became predominantly interested as a bondholder in the defendants and thus adversely interested to the plaintiff in this tax matter. The defendants continued to employ the same common counsel with the plaintiff after the defendants, The Western Pacific Railroad Company and its subsidiaries, were in reorganization and their interests were no longer the same as those of the plaintiff. Plaintiffs officers and general counsel were not conversant with tax matters and relied completely on said tax counsel to protect its rights and more particularly relied on such common tax counsel to advise them if and when any diversity of interest affecting the tax rights of the parties arose so that separate counsel could be retained to protect separate interests. The plaintiff had a right to be advised of its separate rights with respect to the utilization of its losses and excess profits credits and of the fact that it had the right to require an allocation to it of the tax benefit resulting to the

defendants from the use of the plaintiff's tax losses and excess profits credits to discharge the federal income and excess profits tax liabilities of the defendants; the defendants fully realized and had knowledge of this but nevertheless caused the consolidated income and excess profits tax returns to be prepared for each of the three tax periods and presented to the plaintiff through the common tax counsel for signature as a mere matter of routine without disclosing to the plaintiff the adversity in tax interests of the parties or the plaintiff's legal position and rights in the matter. The entire tax matter for the three tax periods was handled by the defendants through the common tax counsel in entire disregard of plaintiff's individual rights and interests and on the basis of effecting the greatest possible tax economies for defendants through the utilization of plaintiff's tax rights until final settlement with the Bureau of Internal Revenue on August 13, 1947, and this was done without consulting or informing the plaintiff as to the progress of the matter until the proposed settlement was presented to the plaintiff through the common tax counsel for ratification and signature. In the settlement with the Bureau of Internal Revenue the defendants waived a claim for refund of consolidated income taxes paid for the year 1942 in the amount of \$4,201,821.54 based upon a carry-back of the plaintiff's 1943 tax losses which amount was payable to the plaintiff by the United States Treasury. The additional income and excess profits tax liabilities of the defendants for the three tax periods

discharged, as confirmed by said settlement, by the filing of the consolidated income and excess profits tax returns and the transfer thereby of the plaintiff's losses and excess profits credits to the use of the defendants was not less than \$17,511,065.25.

The defendants are obligated in equity and good conscience to account for and pay to the plaintiff the tax saving in the amount of \$17,511,065.25 held by the defendants without right but solely as constructive trustees for the plaintiff.

Eleventh: That the obligation of the Trustees of the defendants, The Western Pacific Railroad Company and its subsidiaries, to account for and pay to the plaintiff the aforesaid tax savings was an obligation incurred by the Trustees in their operation of the debtor's estate and was an obligation assumed by the defendant, The Western Pacific Railroad Company, under Orders of this Court in the Bankruptcy Proceeding and properly chargeable against the properly payable out of moneys transferred to the defendant, The Western Pacific Railroad Company, by said Trustees, which moneys vastly exceeded the amount of working capital contemplated by the Plan of Reorganization and the \$17,511,065.25 included therein representing tax savings realized solely by reason of the misfortune of the plaintiff and the utilization by said defendant of plaintiff's rights and which in equity and good conscience belong wholly to the plaintiff and are held by the defendant, The Western Pacific Railroad Company, without any beneficial interest

therein but solely as custodian or trustee for the plaintiff.

Twelfth: In answering the plaintiff's Bill of Complaint the defendants set up and interpose as a bar to the assertion by the plaintiff of its equitable right to an allocation of the tax savings amounting to \$17,511,065.25 the Decree or Order of this Court dated March 28, 1946, which Decree or Order this plaintiff avers is inapplicable to this proceeding and is not a bar to enforcement of the cause of action set up in the Bill of Complaint for the following reasons, among others:

1. The cause of action set up in the Bill of Complaint is in the category of those expressly excepted from the operation of said Decree or Order.

2. The cause of action set up in the Bill of Complaint is in the nature of an equitable accounting for moneys in the custody of but not belonging to the defendant, The Western Pacific Railroad Company, and held by it without beneficial interest therein and solely as custodian or Trustee for the plaintiff.

3. At the time of the entry of said Decree or Order the plaintiff's rights as proprietary parent of the Affiliated Group were inchoate and unliquidated and had not become fixed, liquidated and justiciable until the compromise agreement with the Government hereinbefore mentioned.

4. The aforesaid tax savings although in the

custody of the defendant, The Western Pacific Railroad Company, are held by it in a fiduciary capacity and will be so held until final allocation thereof is made precisely as is the plaintiff in a fiduciary position with respect to the tax refund moneys in its possession in accordance with the Stipulation annexed hereto as Exhibit B. The inchoate right of the plaintiff to an allocation of the aforesaid tax savings resulting from the utilization in the excess profits and income tax returns for the three tax periods of its deductible losses was an unliquidated claim against the Trustees of the estate of the defendant, The Western Pacific Railroad Company, who had requested the plaintiff to file said excess profits and income tax returns on a consolidated basis and who subsequently transferred the entire trust res including moneys representing such tax savings to the defendant, The Western Pacific Railroad Company, subject to all liabilities of said Trustees, one of which was their obligation to the plaintiff to account to it for the tax savings thereafter determined to have resulted from such utilization of the plaintiff's deductible losses.

5. In addition to the foregoing reasons the plaintiff avers that said Decree or Order if deemed applicable to the cause of action set forth in the Bill of Complaint should be set aside or modified so as to exempt said cause of action from its operation for the following further reasons:

(a) The firm of Whitman, Ransom, Coulson & Goetz and James K. Polk, a member thereof, at

the instance of the Trustees, one of whom was the Chief Executive Officer of the plaintiff, were appointed tax counsel for the Trustees and for the plaintiff. Said firm were also counsel for the James Foundation of New York, Inc. Robert E. Coulson, a member of said firm, was a member of the Reorganization Committee of the defendant, the Western Pacific Railroad Company, and said firm was counsel for said Reorganization Committee when said Decree or Order was procured from this Court. Said James Foundation of New York, Inc., owned preferred stock and common stock in the plaintiff as well as being a large secured creditor of the plaintiff. Said James Foundation of New York, Inc., also owned claims against, and securities of the defendant, The Western Pacific Railroad Company. As a consequence of said reorganization and of heavy purchases of securities of said Railroad Company during the progress of the reorganization said James Foundation of New York, Inc., became predominantly interested as bondholder and stockholder of the defendant, The Western Pacific Railroad Company, and by reason of said predominance became adversely interested to the plaintiff.

(b) At the outset of the legal relationship of the firm of Whitman, Ransom, Coulson & Goetz to the Affiliated Group the interests of the parties were identical since the plaintiff was the holder of all capital stock of the defendant, The Western Pacific Railroad Company; but when a reorganization was proposed eliminating the stock interest therein of the plaintiff, which eventually took place,

there was always a potentiality and later an actuality of adverse and conflicting interests between the plaintiff and the defendants. The plaintiff's Officers and General Counsel were not experienced in or conversant with tax matters and wholly relied upon said firm of Whitman, Ransom, Coulson & Goetz and said James K. Polk to keep it fully informed of its rights, it being well established that where attorneys represent conflicting interests there is a fiduciary responsibility on their part to see that no rights or claims are neglected and that full disclosures are made to all parties and to all judicial and administrative tribunals. In the discharge of their duties as tax counsel for all parties concerned said firm of Whitman, Ransom, Coulson & Goetz and said James K. Polk performed in the manner following:

- i. They prepared excess profits and income tax returns for the three tax periods and caused the same to be executed by the plaintiff without pointing out to the plaintiff that the plaintiff as a member of the Affiliated Group was assuming several responsibility for all tax liabilities of the Affiliated Group and was acquiring a right to an equitable determination or allocation of the tax benefits, if any, arising from the filing of said Returns on a consolidated basis;

- ii. They entered into negotiations with the Commissioner of Internal Revenue for a settlement of the tax liabilities of the Affiliated Group without informing the plaintiff thereof;

iii. On February 11, 1947, they transmitted to the Commissioner of Internal Revenue a formal written offer of settlement for tax liabilities without informing the plaintiff of said offer;

iv. They failed to advise the plaintiff corporation of substantial tax benefits implicit if the deductible losses of the plaintiff were accepted by the Government as set up in said excess profits and income tax returns;

v. Throughout their representation of the plaintiff they failed to advise the plaintiff as to what were its rights as a member of the Affiliated Group filing said Returns on a consolidated basis and failed to advise it of its right to an allocation of tax benefits in mitigation of its losses; and

vi. Finally, they failed to advise the Court in the reorganization proceeding at the time of their submission of the Decree or Order dated March 28, 1946, of their various conflicting interests and failed to advise the Court that there would be a right in the plaintiff to bring an action for an equitable allocation of tax benefits if the excess profits and income tax returns were accepted by the Government which right of action might be barred by said Decree or Order resulting in irreparable injury to the plaintiff and in the unjust enrichment of another of their clients, namely, the James Foundation of New York, Inc.

For all of the foregoing reasons the plaintiff alleges that said Decree or Order of March 28, 1946, if susceptible to the construction sought to be placed upon it by the defendant, The Western

Pacific Railroad Company, should be modified so as to exempt this particular cause of action from its operation or should be set aside in its entirety as having been improvidently entered.

The plaintiff does not aver that in so conducting themselves the firm of Whitman, Ransom, Coulson & Goetz or James K. Polk were aware of wrongdoing or consciously disregarded the interests of the plaintiff. It is quite possible that their actions or inaction were inadvertent and that said firm or James K. Polk were unaware or unconvinced of the plaintiff's rights; but whether inadvertent or intentional their disregard of the plaintiff's rights and their failure to inform the Court thereof, at a time when the diversity of interest was apparent, would render the operation of said Decree or Order as a bar to the plaintiff's cause of action grossly inequitable and wholly inadmissible.

Thirteenth: That the plaintiff verily believes and alleges that the whole of said sum of \$17,511,065.25 is due and owing to it and that there are no valid offsets or counterclaims there against or against the plaintiff on the part of any of the defendants but if any such claims do exist or are thought to exist by any of the defendants such claims should be required to be filed and adjudicated in this proceeding to the end that all accounts between the plaintiff and its former affiliated companies may be judicially settled.

Fourteenth: Reference herein to the defendants includes the corporations named herein as defend-

ants whether acting through their corporate officers or authorized agents or through Trustees during the period of trusteeship.

Wherefore, the plaintiff demands judgment in accordance with the prayer of the Bill of Complaint and specifically that the defendant, The Western Pacific Railroad Company, be adjudged and decreed to be accountable to the plaintiff for the sum of \$17,511,065.25 and that judgment in favor of the plaintiff and against the defendant, The Western Pacific Railroad Company, be rendered for said sum; that the accounts of the plaintiff with all or any of its former affiliated companies may be judicially settled and the plaintiff discharged from any liabilities in respect thereof; and that the plaintiff be accorded such other and further relief as shall be agreeable to the usages and practices of equity and the Rules of Civil Procedure and as to this Court shall seem meet.

THE WESTERN PACIFIC
RAILROAD CORPORATION.

By /s/ LEROY R. GOODRICH,
Its Attorney.

Of Counsel:

FRANK C. NICODEMUS, JR.,
A. PERRY OSBORN,
NORRIS DARRELL.

[Endorsed]: Filed December 17, 1947.

[Exhibits A, B and C attached to the Supplemental Bill of Complaint are identical to the Stipulation and Agreement between Plaintiff and Defendant Relating to Agreement with the Bureau of Internal Revenue. See pages 168 to 175 inclusive.

[Title of District Court and Cause.]

ANSWER OF DEFENDANT THE WESTERN
REALTY COMPANY

Comes now defendant The Western Realty Company, and answering plaintiff's supplemental bill of complaint, respectfully shows and alleges:

I.

Denies each and every allegation contained in paragraph "First," except it is informed and believes and therefore admits that the consolidated income and excess profits tax returns filed by plaintiff and its affiliated companies for the years 1942, 1943 and the first four months of 1944 had not been finally audited by the Commissioner of Internal Revenue at the time of the filing of the bill of complaint herein and that commencing on February 11, 1947, negotiations were entered into with the Commissioner of Internal Revenue to settle the tax liabilities of plaintiff and its affiliated companies and on February 11, 1947, and on May 19, 1947, offers to settle the tax liabilities of plaintiff and its affiliated companies were made in the words and figures of Exhibit A annexed to the supplemental bill of complaint and Exhibit 1 hereto annexed.

II.

Denies each and every allegation contained in paragraph "Second," except it is informed and believes and therefore admits that offers of settlement were made on behalf of plaintiff and its affiliated companies in the words and figures of Exhibit A annexed to the supplemental bill of complaint and Exhibit 1 hereto annexed.

III.

Denies that it has any knowledge or information sufficient to form a belief as to the truth of each and every allegation contained in paragraph "Third," except it denies that plaintiff would be the beneficiary of any tax savings.

IV.

Denies that it has any knowledge or information sufficient to form a belief as to the truth of each and every allegation contained in paragraph "Fourth," except it admits that it entered into a stipulation with plaintiff and others in the words and figures of Exhibit B annexed to the supplemental bill of complaint.

V.

Denies each and every allegation contained in paragraph "Fifth," except it is informed and believes and therefore admits that under date of August 13, 1947, the Commissioner of Internal Revenue addressed a letter to plaintiff and its affiliated companies, copy of which is annexed to the supplemental bill of complaint as Exhibit C.

VI.

Denies each and every allegation contained in paragraph "Sixth," except it is informed and believes and therefore admits that under date of August 26, 1947, the Commissioner of Internal Revenue addressed a letter to plaintiff and its affiliated companies, copy of which is annexed to the supplemental bill of complaint as Exhibit D.

VII.

Denies each and every allegation contained in paragraph "Seventh," except it denies that it has any knowledge or information sufficient to form a belief as to the truth of the allegations that plaintiff employed Lybrand, Ross Bros. & Montgomery to make the calculations alleged, that Lybrand, Ross Bros. & Montgomery did, in fact, make such calculations, and it is informed and believes and therefore admits that no other or additional payments were made to the Collector of Internal Revenue by plaintiff and its affiliated companies for the years 1942, 1943 and the first four months of 1944 than the \$4,201,821.54 paid by the Trustees in Reorganization of defendant The Western Pacific Railroad Company for the year 1942.

VIII.

Denies each and every allegation contained in paragraph "Eighth," except it admits that from time to time the Internal Revenue Code and the several Revenue Acts in force from 1917 to 1938 have provided that affiliated companies meeting the

requirements therein laid down may file tax returns on a consolidated basis and begs leave upon the trial of the action to refer to the pertinent provisions of the Internal Revenue Code and Regulations with respect to the rights, duties and liabilities of affiliated companies having the right to and availing themselves of the privilege of filing tax returns on a consolidated basis.

IX.

Denies each and every allegation contained in paragraph "Ninth," except it is informed and believes and therefore admits that plaintiff had no taxable income during the years 1942, 1943 and the first four months of 1944 and sustained substantial losses in the year 1943 which it had the right to carry back and to carry forward as an offset against taxable income, that certain of the defendants had taxable net income during the years 1942, 1943 and the first four months of 1944, that plaintiff and defendants, as affiliated corporations, had the right to and did file consolidated income and excess profits tax returns and utilized certain losses of plaintiff in the returns for the years 1942, 1943 and the first four months of 1944.

X.

Denies each and every allegation contained in paragraph "Tenth," except it is informed and believes and therefore admits that James K. Polk was and is a specialist in tax matters and was and is a member of the firm of Whitman, Ransom, Coulson & Goetz, counsel for The James Foundation of New York, Inc., a stockholder and creditor of plaintiff

and a creditor of defendant prior to and during the reorganization, and that James K. Polk and Whitman, Ransom, Coulson & Goetz were employed to advise and did advise the Trustees in Reorganization of defendant The Western Pacific Railroad Company in tax matters.

XI.

Denies each and every allegation contained in paragraph "Eleventh."

XII.

Denies each and every allegation contained in paragraph "Twelfth," and begs leave upon the trial of the action to refer to the answers interposed by defendants to the bill of complaint for a true and correct statement of the allegations thereof, and it is informed and believes and therefore admits that Whitman, Ransom, Coulson & Goetz and James K. Polk were employed to advise the reorganization trustees of defendant The Western Pacific Railroad Company on tax matters, that Whitman, Ransom, Coulson & Goetz were counsel for The James Foundation of New York, Inc., that Robert E. Coulson, a member of said firm, was a member of the reorganization committee of defendant The Western Pacific Railroad Company, that Whitman, Ransom, Coulson & Goetz were counsel for such reorganization committee, that The James Foundation of New York, Inc., was a stockholder and creditor of plaintiff and of defendant The Western Pacific Railroad Company and that James K. Polk conducted negotiations with the Commissioner of Internal Revenue

leading up to the settlement of the tax liabilities of the affiliated group for the years 1942, 1943 and the first four months of 1944.

XIII.

Denies each and every allegation contained in paragraph "Thirteenth."

For a First Separate and Complete defense, defendant alleges:

XIV.

The bill of complaint and the supplemental bill of complaint fail to state a claim against defendant upon which relief can be granted.

Wherefore, defendant demands judgment that the bill of complaint and the supplemental bill of complaint be dismissed as to it, together with costs and disbursements.

PILLSBURY, MADISON &
SUTRO,

EUGENE M. PRINCE,
EVERETT A. MATHEWS,
HOMER G. ANGELO,

WHITMAN, RANSOM,
COULSON & GOETZ,

MILBANK, TWEED, HOPE &
HADLEY,

By /s/ EVERETT A. MATHEWS,
Attorneys for Defendant The
Western Realty Company.

EXHIBIT 1

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York 5, N.Y.

May 19, 1947.

Mr. C. R. Krigbaum
Internal Revenue Agent in Charge
225 Broadway
New York, N.Y.

The Western Pacific Railroad Corporation
and Affiliated Corporations 1942, 1943 and
1944 Federal Income Taxes

Dear Sir:

Reference is made to the conference held in your office May 6th with regard to the tax liabilities of The Western Pacific Railroad Corporation and its affiliated companies for the taxable years 1942, 1943 and 1944.

At this conference an agreed basis of settlement of the tax liabilities involved was reached and this letter contains the written undertaking of the taxpayers effectuating the settlement.

The taxpayer on behalf of itself and its affiliated subsidiaries agrees to settle and determine the tax liabilities of said corporation for the taxable years 1942, 1943, and 1944 in the amounts shown on the returns as filed. This proposal of settlement accordingly relates to the consolidated returns filed for the calendar years 1942 and 1943 and 1944, in which

said return for 1944 The Western Pacific Railroad Corporation included therein its subsidiaries for the period January 1, 1944 to April 30, 1944, during which period affiliation existed. This settlement does not relate to or affect the tax liability of the subsidiaries from and after April 30, 1944, when their affiliated status with The Western Pacific Railroad Corporation was terminated.

As part of the settlement The Western Pacific Railroad Corporation consents to the rejection of the pending claim for refund of 1942 taxes and further agrees not to sue upon said claim or file other or further claims in respect of 1942 taxes on any ground whatsoever. It is also stipulated that The Western Pacific Railroad Corporation on behalf of itself and its affiliated subsidiaries will, if this settlement is accepted, execute or procure the execution of any other or further agreements or assurances requested by the Commissioner of Internal Revenue for the purpose of effectuating the settlement.

The settlement reached with your office is agreed to without prejudice, however, to any rights or claims of the parties in the event the settlement is not accepted by the Commissioner of Internal Revenue.

Authority for settlement of the tax liabilities of the above-named taxpayers by the undersigned is

contained in power of attorney heretofore filed with your office.

Respectfully,

THE WESTERN PACIFIC
RAILROAD CORPORATION,
JAMES K. POLK,
Attorney-in-Fact.

Receipt of Copy Attached.

[Endorsed]: Filed June 14, 1948.

[Title of District Court and Cause.]

ANSWER OF DEFENDANTS THE WESTERN
PACIFIC RAILROAD COMPANY, SACRA-
MENTO NORTHERN RAILWAY, TIDE-
WATER SOUTHERN RAILWAY COM-
PANY, DELTA FINANCE CO., LTD., AND
STANDARD REALTY AND DEVELOP-
MENT COMPANY TO PLAINTIFF'S SUP-
PLEMENTAL BILL OF COMPLAINT

Come Now defendants The Western Pacific Rail-
road Company, Sacramento Northern Railway,
Tidewater Southern Railway Company, Delta Fin-
ance Co., Ltd., and Standard Realty and Develop-
ment Company and, without waiving any objections
to plaintiff's Supplemental Bill of Complaint (here-
inafter for convenience referred to as the Supple-
mental Complaint) and specifically reserving the
right to make objections to the propriety of said

Supplemental Complaint and to the filing thereof, by way of answer thereto admit, deny and allege as follows:

I.

Deny all of the allegations of paragraph first of the Supplemental Complaint, except the following which are admitted: At the time of the filing of the Bill of Complaint herein the consolidated income and excess profits tax returns of the plaintiff and its affiliated companies (hereinafter for convenience called the Affiliated Group) for the years 1942 and 1943 and the period January 1, 1944, to April 30, 1944, had not been finally audited and accepted by the Commissioner of Internal Revenue.

II.

Admit the allegations of paragraph second of the Supplemental Complaint.

III.

Answering the allegations of paragraph third of the Supplemental Complaint, these defendants allege that they are without knowledge or information sufficient to form a belief with regard to whether or not plaintiff had been informed that the said offer of settlement, Exhibit A to the Supplemental Complaint (being also set forth in Exhibit A to the stipulation and agreement filed in this cause September 5, 1947) was to be submitted to the Commissioner of Internal Revenue in advance of the transmission thereof to said Commissioner on February 11, 1947, and except as last above stated deny each and every allegation contained in paragraph third

of said Supplemental Complaint. Further answering the allegations of said paragraph third, allege that negotiations with the Commissioner of Internal Revenue to settle the tax liabilities of these defendants to the United States were commenced February 11, 1947, and in connection with such negotiations, offers for settlement of the tax liability to the United States were made February 11, 1947, and May 19, 1947, in the words and figures of said Exhibit A and Exhibit 1 annexed to this answer.

IV.

Answering the allegations of paragraph fourth of the Supplemental Complaint, allege that these defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations therein contained except these defendants admit that they entered into a stipulation and agreement in writing with the plaintiff and the defendant, Western Realty Company, which said stipulation was filed in this cause September 5, 1947, and is the stipulation mentioned in paragraph III of this Answer.

V.

Deny each and every allegation contained in paragraph fifth of the said Supplemental Complaint except these defendants admit that under date of August 13, 1947, the Commissioner of Internal Revenue addressed to the plaintiff and affiliated companies a letter dated August 13, 1947, copy of which is annexed to the Supplemental Complaint as Exhibit C thereto (being also set forth in Exhibit A

to the aforesaid stipulation filed in this cause September 5, 1947).

VI.

Deny each and every allegation contained in paragraph sixth of the said Supplemental Complaint except that these defendants admit that under date of August 26, 1947, the Commissioner of Internal Revenue addressed a letter to plaintiff and affiliated companies, copy of which is annexed to the Supplemental Complaint as Exhibit D thereto (being also set forth in Exhibit A to the aforesaid stipulation filed in this cause September 5, 1947).

VII.

Deny each and every allegation contained in paragraph seventh of the Supplemental Complaint except these defendants allege that they are without knowledge or information sufficient to form a belief as to the truth of the allegations that plaintiff employed Lybrand, Ross Bros. & Montgomery to make calculations alleged and that they in fact made such calculations, and except that these defendants admit that no payments were made to the Commissioner of Internal Revenue by these defendants or any of them or by the plaintiff for income and excess profits taxes for the years 1942, 1943 and the first four months of 1944 other than the \$4,201,821.54 paid by the Reorganization Trustees in the reorganization of defendant, The Western Pacific Railroad Company, for the year 1942.

VIII.

Deny each and every allegation contained in paragraph eighth of said Supplemental Complaint except these defendants admit that from time to time the laws and statutes relating to Federal income and excess profits taxes and regulations thereunder have made provisions with respect of the filing of consolidated income and excess profit tax returns.

IX.

Deny each and every allegation contained in paragraph ninth of the Supplemental Complaint except these defendants are informed and believe and therefore admit that plaintiff had no taxable income during the years 1942, 1943 and 1944, nor in the first four months of 1944, and that plaintiff sustained losses in each of the calendar years 1942, 1943 and 1944 and that certain of these defendants had taxable net income during the years 1942, 1943 and the first four months of 1944 and that plaintiff and defendants as companies affiliated during said years and portion of year had the right to and did file consolidated income and excess profits tax returns for said years, 1942, 1943 and 1944 (these defendants having been included in said consolidated return for the year 1944, as to the first four months of that year) and that a substantial portion of the loss of the plaintiff in the year 1943 was carried forward in the said consolidated income and excess profits tax returns for the year 1944.

X.

These defendants deny each and every allegation contained in paragraph tenth of said Supplemental Complaint except they admit that James K. Polk was and is a member of the firm of Whitman, Ransom, Coulson & Goetz, counsel for The James Foundation of New York, Inc., which was a stockholder and creditor of plaintiff and a creditor of defendant, The Western Pacific Railroad Company, prior to and during the reorganization of said last named Company, and that the said Polk and the said firm were employed to advise and did advise the Reorganization Trustees in the reorganization of said last named defendant in tax matters.

XI.

Deny each and every allegation contained in paragraph eleventh of said Supplemental Complaint.

XII.

Answering the allegations of paragraph twelfth of the Supplemental Complaint,—

(a) Admit and allege that in answering plaintiff's Bill of Complaint herein these defendants have set up and do interpose as a bar to the assertion by plaintiff of its pretended claim the decree and order of the Bankruptcy Court in said Reorganization Proceedings dated March 28, 1946; that the firm of Whitman, Ransom, Coulson & Goetz and James K. Polk, a member thereof, were employed by the aforesaid Reorganization Trustees as tax counsel to advise regarding the preparation

and filing of consolidated income and excess profits tax returns for the years 1942 and 1943 and the first four months of 1944; that said firm was counsel for The James Foundation of New York, Inc.; that Robert E. Coulson, a member of said firm, was nominated jointly by A. C. James Co. and Railroad Credit Corporation to be a member of the Reorganization Committee of defendant The Western Pacific Railroad Company and was appointed as such by the Interstate Commerce Commission and the Bankruptcy Court; that said firm was counsel for said Reorganization Committee; that The James Foundation of New York, Inc., was a stockholder and creditor of plaintiff and was a secured creditor of the debtor in reorganization, and from and after January 1, 1945, has been and is a stockholder of defendant The Western Pacific Railroad Company; that said James K. Polk conducted negotiations with the Bureau of Internal Revenue leading up to the settlement that was made in August, 1947, of the income and excess profits tax liabilities of the affiliated group for the years 1942 and 1943 and the first four months of 1944, said settlement being shown by the aforesaid stipulation, filed in this cause September 5, 1947; and that on April 2, 1947, and thereafter said Polk fully advised plaintiff with regard thereto and that thereafter plaintiff approved and agreed to said settlement.

(b) Except as hereinbefore admitted and alleged, deny each and every allegation contained in

paragraph twelfth of said Supplemental Complaint.

XIII.

Deny each and every allegation contained in paragraph thirteenth of the Supplemental Complaint.

XIV.

Deny each and every allegation contained in paragraph fourteenth of the Supplemental Complaint.

XV.

Further answering said Supplemental Complaint, these defendants refer to and by such reference incorporate herein all the allegations contained in their answer and counterclaim on file herein with the same force and effect as if set forth in full and repeated in this answer to said Supplemental Complaint.

XVI.

For a further and separate defense to the plaintiff's Complaint and Supplemental Complaint herein, these defendants allege that said Complaint and Supplemental Complaint and each cause of action therein fail to state a claim against these defendants or any of them upon which relief can be granted.

XVII.

For a further and separate defense to the plaintiff's Complaint and Supplemental Complaint, these defendants allege that this Court, without bankruptcy jurisdiction, is without jurisdiction or power to modify or set aside, in whole or in part, the orders, judgments and decrees made by the

Bankruptcy Court in the said reorganization proceedings or any thereof.

XVIII.

For a further and separate defense to the plaintiff's Complaint and Supplemental Complaint, these defendants allege that neither said Complaint nor said Supplemental Complaint name as defendants indispensable and necessary parties.

XIX.

At all times from August 2, 1935, to March 28, 1946, the rights of plaintiff against the defendant, The Western Pacific Railroad Company, and the Reorganization Trustees were before this Court for adjudication in the reorganization proceeding. Plaintiff could have obtained in the reorganization proceeding an express adjudication of the claims which are presented in this action. Failure of plaintiff to do so renders said claims forever barred under the principles of res adjudicata.

XX.

At no time before the institution of this action did plaintiff or any one in behalf of plaintiff in any way assert the claims which are the subject of this action. If they had asserted these claims promptly, the defendant, The Western Pacific Railroad Company, the Reorganization Trustees and all parties to the reorganization proceeding could have applied to the Court conducting the reorganization for an order directing plaintiff to file the consolidated returns for 1942, 1943 and 1944 and the refund claim

for 1942 without any charge by or in behalf of the plaintiff for compensation to it. If that application had been denied, the Reorganization Trustees and the defendants could then have elected to file separate income tax returns and to avail themselves of the rights, privileges, options and advantages belonging to the persons who pay taxes to the Federal Government. The Reorganization Trustees and the defendants could have taken steps to improve their tax position, among other things, by taking advantage of the tax benefit which would arise from a determination of the insolvency of the defendant, Sacramento Northern Railway. The Reorganization Trustees and the defendants have, in reliance of the silence of the plaintiff, changed their position to their detriment. Plaintiff is therefore estopped from asserting its claims. It is also estopped from maintaining in this action a position inconsistent with the position plaintiff maintained in the reorganization proceedings. Plaintiff is further precluded from maintaining its claims by reason of the fact that the concurrence of each member of the affiliated group was necessary in order that consolidated returns might be filed. The claims of plaintiff to the alleged tax saving are therefore unjust and unconscionable because plaintiff's claim to the alleged saving would in no event be better than the claim of each of the defendants.

XXI

These defendants allege that by reason of the circumstances set forth in this Answer and in their

Answer to the plaintiff's Complaint herein the claims of plaintiff are barred by each of the following defenses: Discharge in bankruptcy pursuant to Section 77 of the Bankruptcy Act, res adjudicata, estoppel, laches, failure of consideration, illegality, statute of limitations and waiver.

Wherefore, these defendants pray for the order, judgment and decree of this Honorable Court

1. Declaring and determining that defendant, The Western Pacific Railroad Company, is the sole owner of and is exclusviely entitled to the reserve fund and refund claim mentioned in its Answer to plaintiff's Complaint hereunder, and quieting the right and title to said defendant therein and there-to against the claims of plaintiff and all other parties to this cause and restraining and enjoining plaintiff and all other parties to this suit other than defendant, The Western Pacific Railroad Company, from instituting or prosecuting claims thereto.

2. Declaring and determining that plaintiff has no rights or claims against these defendants or any of them for or on account of any matter or thing averred in planitiff's Complaint or Supplemental Complaint herein.

3. For defendant's costs of suit herein and all such other and further relief that may be meet and equitable in the premises.

Dated: June 22, 1948.

THE WESTERN PACIFIC RAILROAD COM-
PANY,

SACRAMENTO NORTHERN RAILWAY,
TIDEWATER SOUTHERN RAILWAY COM-
PANY,

DELTA FINANCE CO., LTD.,

STANDARD REALTY AND DEVELOPMENT
COMPANY,

By /s/ ALLAN P. MATTHEW,

JAMES D. ADAMS,

ROBERT L. LIPMAN,

BURNHAM ENERSEN,

Their Attorneys.

EXHIBIT 1

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York 5, N. Y.

May 19, 1947

Mr. C. R. Krigbaum

Internal Revenue Agent in Charge

225 Broadway

New York, N. Y.

The Western Pacific Railroad Corporation
and Affiliated Corporations, 1942, 1943 and
1944 Federal Income Taxes.

Dear Sir:

Reference is made to the conference held in your
office May 6th with regard to the tax liabilities of
The Western Pacific Railroad Corporation and its

affiliated companies for the taxable years 1942, 1943 and 1944.

At this conference an agreed basis of settlement of the tax liabilities involved was reached and this letter contains the written undertaking of the taxpayers effectuating the settlement.

The taxpayer on behalf of itself and its affiliated subsidiaries agrees to settle and determine the tax liabilities of said corporation for the taxable years 1942, 1943 and 1944 in the amounts shown on the returns as filed. This proposal of settlement accordingly relates to the consolidated returns filed for the calendar years 1942 and 1943 and 1944, in which said return for 1944 The Western Pacific Railroad Corporation included therein its subsidiaries for the period January 1, 1944, to April 30, 1944, during which period affiliation existed. This settlement does not relate to or affect the tax liability of the subsidiaries from and after April 30, 1944, when their affiliated status with The Western Pacific Railroad Corporation was terminated.

As part of the settlement The Western Pacific Railroad Corporation consents to the rejection of the pending claim for refund of 1942 taxes and further agrees not to sue upon said claim or file other or further claims in respect of 1942 taxes on any ground whatsoever. It is also stipulated that The Western Pacific Railroad Corporation on behalf of itself and its affiliated subsidiaries will, if this settlement is accepted, execute or procure the execution of any other or further agreements or assurances requested by the Commissioner of Internal

Revenue for the purpose of effectuating the settlement.

The settlement reached with your office is agreed to without prejudice, however, to any rights or claims of the parties in the event the settlement is not accepted by the Commissioner of Internal Revenue.

Authority for settlement of the tax liabilities of the above-named taxpayers by the undersigned is contained in power of attorney heretofore filed with your office.

Respectfully,

THE WESTERN PACIFIC
RAILROAD CORPORATION,

JAMES K. POLK,
Attorney-in-Fact.

Receipt of copy attached.

[Endorsed]: Filed June 22, 1948.

[Title of District Court and Cause.]

STIPULATION FOR SUBSTITUTION OF
MEREDITH H. METZGER, FORMERLY
MEREDITH H. VAN KIRK, AS A PLAINTIFF
IN INTERVENTION

Pursuant to stipulation of the parties entered into at the pretrial conference herein on January 11, 1949, and upon the representation by counsel for in-

terveners that 8,200 shares of the preferred stock of plaintiff and defendant in intervention The Western Pacific Railroad Corporation out of the 11,468 shares alleged in the Complaint in Intervention herein to be held by plaintiff in intervention, Russell M. Van Kirk, now deceased, were distributed on or about January 17, 1949, to Meredith H. Metzger, formerly Meredith H. Van Kirk, widow of said decedent, in the estate of said decedent now pending before the Surrogate of the County of Monmouth, State of New Jersey, said decedent Russell M. Van Kirk having died in December, 1947, during the pendency of this action; that said Meredith H. Metzger is now the lawful owner and holder of 11,385 shares of said preferred stock of said Corporation including said 8,200 shares so distributed to her from the estate of her deceased husband and through the ownership of said shares either she or her deceased husband has been a stockholder of said Corporation continuously since on or about February 23, 1944; and that the said Meredith H. Metzger is now and continuously since some years prior to April 7, 1947, the date of the filing of said Complaint in Intervention herein, has been a citizen and resident of the State of New Jersey.

It Is Hereby Stipulated and Agreed by and between the respective parties hereto that the said Meredith H. Metzger, formerly Meredith H. Van Kirk, widow of said deceased plaintiff in intervention, Russell M. Van Kirk, shall be substituted as

'a plaintiff in intervention herein in the place and stead of the said Russell M. Van Kirk, deceased, as the owner and holder of his said shares, to wit, the 8,200 shares so distributed to her out of the estate of said decedent, and as the owner of a total of 11,385 shares of the preferred stock of said Corporation, subject to all prior proceedings had herein and to all claims and defenses heretofore raised by any of the parties hereto with the same force and effect as if she had been one of the original plaintiffs in intervention herein owning and holding 11,385 shares of the preferred stock of said Corporation and having been a stockholder of said Corporation continuously since on or about February 23, 1944; and that the requirements of Rule 25, FRCP, with respect to motion, notice of hearing and hearing are hereby waived.

Dated: January 27, 1949.

WEBSTER V. CLARK.
ROGERS AND CLARK,
DAVID FREIDENRICH,
JULIUS LEVY,
ABRAHAM L. POMERANTZ.
POMERANTZ, LEVY,
SCHREIBER & HAUDEK,

By /s/ WEBSTER V. CLARK,

Attorneys for Russell M. Van Kirk, Henry Offerman and J. S. Farlee & Co., Inc., a corporation, Plaintiffs in Intervention.

LEROY R. GOODRICH,
FRANK C. NICODEMUS, JR.,
A. PERRY OSBORN,
NORRIS DARRELL,
MAHLON DICKERSON,
BROBECK, PHLEGER &
HARRISON,

By /s/ MAHLON DICKERSON,

Attorneys for Plaintiff and Defendant in Inter-
vention, The Western Pacific Railroad Cor-
poration.

PILLSBURY, MADISON &
SUTRO,

EUGENE M. PRINCE,
EVERETT A. MATHEWS,
HOMER G. ANGELO.

WHITMAN, RANSOM, COUL-
SON & GOETZ,

MILBANK, TWEED, HOPE &
HADLEY.

By /s/ A. DONALD MacKINNON,

Attorneys for Defendant and Defendant in Inter-
vention, The Western Realty Company.

ALLAN P. MATTHEW,
JAMES D. ADAMS,
ROBERT L. LIPMAN,
BURNHAM ENERSEN,
McCUTCHEN, THOMAS,
MATTHEW, GRIFFITHS
& GREENE,

By /s/ JAMES D. ADAMS,

Attorneys for Defendants and Defendants in Intervention, The Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway Company, Delta Finance Co., Ltd., and Standard Realty and Development Company.

ORDER

Pursuant to the foregoing stipulation and the stipulation entered into by the parties at the pre-trial conference herein on January 11, 1949, and good cause appearing therefor, it is hereby ordered that Meredith H. Metzger, formerly Meredith H. Van Kirk, the widow of the plaintiff in intervention, Russell M. Van Kirk, now deceased, and the distributee in the estate of said decedent of 8,200 shares of the preferred stock of plaintiff and defendant in intervention, The Western Pacific Railroad Corporation, owned and held by said decedent, be and she is hereby substituted as a plaintiff in intervention herein in the place and

stead of said decedent as the owner and holder of his said shares, subject to all prior proceedings had herein and to all claims and defenses heretofore raised by any of the parties hereto with the same force and effect as if she, the said Meredith H. Metzger, had been one of the original plaintiffs in intervention herein owning and holding 11,385 shares of the preferred stock of said Corporation and having been a stockholder of said Corporation continuously since on or about February 23, 1944.

Dated: January 28th, 1949.

/s/ LOUIS E. GOODMAN,
United States District Judge.

[Endorsed]: Filed January 28, 1949.

[Title of District Court and Cause.]

OPINION

Goodman, District Judge.

Plaintiff, a former holding company, whose interest in its subsidiary had been finally declared valueless in the subsidiary's reorganization proceeding under § 77 of the Bankruptcy Act, has tendered the novel claim that it should be awarded, in equity, a part, if not all, of the subsidiary's income tax saving while in reorganization, resulting from the filing of consolidated corporate income tax returns.

A somewhat detailed history must be set down

in order to properly appraise the unique demand of plaintiff.

Plaintiff is The Western Pacific Railroad Corporation; its subsidiary was Western Pacific Railroad Company, an operating railroad company, herein referred to as the "debtor"; defendant, the reorganized subsidiary, is The Western Pacific Railroad Company.

Statement of Facts

Plaintiff corporation, a so-called holding company, from 1916 to April 30, 1944, owned all the outstanding capital stock of the debtor. For some years prior to 1935, the financial condition of the debtor had been steadily worsening. In 1935 it filed a petition under Section 77 of the Bankruptcy Act (11 USC 205) and this Court in that year placed its affairs in the hands of trustees. Thereafter a plan of reorganization was proposed and in 1939 it was approved by the Interstate Commerce Commission. 233 ICC 409. Inter alia, it was determined in the plan that the capital stock of the debtor owned by the plaintiff was without equity or value and that plaintiff and its stockholders therefore were not entitled to participate in the plan. In 1940 this Court approved the plan of reorganization, including approval of the findings of the Interstate Commerce Commission as to the worthlessness of the plaintiff's equity. The Circuit Court of Appeals (now Court of Appeals) of the Ninth Circuit reversed in 1941 (124 F. 2d 136). In 1943 the Su-

preme Court reversed the Circuit Court and affirmed the order of the District Court. (318 U.S. 448). It there considered and rejected the contention of the plaintiff that it should have the right to participate in the plan because of recent increased earnings of the debtor. (318 U.S. 508, 509.)

¹ Thereafter, the plan of reorganization was, in accordance with the statutory provisions (11 USC 205e), submitted to the creditors, and, after their approval, the plan was confirmed on October 11, 1943, by this Court. The reorganization committee designated in the plan of reorganization, instead of forming a new corporation, determined to use the corporate structure or shell of the old company (debtor) and to execute the plan of reorganization by revesting its former properties in the reorganized company, i.e., the defendant. On November 22, 1943, an agreement was made between the plaintiff, its secured creditors and the reorganization committee wherein a modus of revesting was set up. Among other things, the plaintiff agreed therein to transfer all of its stock in the debtor to the reorganization committee. This agreement was approved by this Court, in December, 1943. The transfer of the stock was not actually made until April, 1944, because of an unsuccessful litigative² attempt

¹ See in re Denver & R.G.W.R. Co. 10 Cir. 150 Fed. 2d 28 and R.F.C. v. D. & R.G.R. Co. 328 U.S. 495, where similar holdings upon similar contentions were made.

² Bryant v. Western Pac. R. Corp. 35 A. 2d 909 (Del. Ch. Feb. 10, 1944.)

to prevent the same. During the period of years in which the plaintiff was the owner of all the outstanding stock of the debtor, plaintiff had followed the practice of filing consolidated or affiliated income tax returns, in which it had reported the earnings of the debtor as well as other affiliated companies, which the plaintiff wholly or partly owned. The amount of taxes paid by the plaintiff pursuant to such returns was allocated among the various subsidiary companies having taxable income in proportion to the amount of such taxable income. The practice of filing the consolidated returns continued throughout the reorganization period. The returns, during the reorganization period, were prepared by the employees of the debtor and signed by the president of the plaintiff corporation, although they were never submitted to its board of directors for approval or consideration.

During the year 1942, the debtor made substantial net earnings. Neither plaintiff, nor any of its other subsidiary companies, had any earnings during 1942. A consolidated return was filed for the year 1942 in which the tax liability, due to the earnings of the debtor, was \$4,144,828. Later in 1943, after the filing of the 1942 return and payment of the tax, the tax attorneys for defendant "discovered" Section 123 of the Revenue Act of 1942. (26 USC 23(g)4.)³ They proposed what they de-

³ "Stock in affiliated corporation. For the purposes of paragraph (2) stock in a corporation affiliated with the taxpayer shall not be deemed a capi-

noted a "paradoxical" theory, by which the worthlessness of the plaintiff's stock (which had cost the plaintiff some \$75,000,000) in the operating railroad company (debtor), might be availed of as an offset to the operating income of the debtor and thus result in a net loss and no tax obligation. Further, their theory was that part of this \$75,000,000 loss in 1943, could be "carried back" to 1942 (§122(b)(1) of the Internal Revenue Code.) and part could be "carried over" to 1944 (§122(b)(2) of the Internal Revenue Code.).

Thereupon a claim for refund of the amount of tax paid for 1942 was filed in the name of the plaintiff. Operations of the debtor during 1943 and up to April 30, 1944, were increasingly profitable and, except for the offset of the capital stock loss of the plaintiff itself, would have called for the payment of some \$17,000,000 in income taxes. So the tax attorneys caused the filing of consolidated tax returns for 1943 and for the forepart of 1944 in the name of plaintiff, in which sufficient portions of the \$75,000,000 stock loss were used as offsets against the operating accounts for these years, so as to show no net income. The validity of the offsets was questioned by the Commissioner of Internal Revenue and conferences were had between the tax counsel for the defendant and the Commissioner. As a result, a tax settlement was made with the Commis-

tal asset." (Subsection 4 of § 23g). By this subsection, losses resulting from worthlessness of stock of an affiliate became operating losses instead of capital losses as theretofore.

sioner whereby, in consideration of the withdrawal of the claim for refund, the Commissioner accepted and approved the returns. The nature and basis of this compromise settlement will be hereafter more fully discussed.

Subsequent to the filing of the claim for refund of the 1942 tax paid, and the filing of the consolidated tax returns for 1943 and part of 1944, and after negotiations for the settlement of the entire tax issue with the Commissioner of Internal Revenue had started, the plaintiff, on October 10, 1946, filed its bill of complaint in equity herein. In substance the bill of complaint recited the filing of the claim for refund, the commencement of the negotiations for the approval of the consolidated returns and prayed that the Court settle the proprietary rights of the plaintiff and the defendant in the tax saving involved. It was further prayed that funds equivalent to the tax savings be placed in the custody of the court for proper and equitable distribution.⁴

On April 7, 1947, the Court permitted the filing of a complaint in intervention on behalf of certain stockholders of the plaintiff who wished to join in the demand of the plaintiff and in its prayer for relief against the defendant. The settlement and agreement with the Commissioner, by which the claim for refund was withdrawn and the consoli-

⁴ The debtor had on two separate occasions set aside reserve funds for the payment of the taxes, to protect against the contingency of adverse ruling by Commissioner or Court.

dated returns for the years 1942, 1943 and part of 1944 were accepted and approved, was consummated on August 14, 1947.

On December 17, 1947, plaintiff filed a supplementary bill of complaint, wherein the consummation of the settlement and compromise was set forth. It was there further alleged that the defendant through its officers and attorneys had controlled the board of directors of the plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant. Throughout the proceedings and in the trial, this has been referred to as "duality of control."

In the supplementary complaint, the plaintiff prayed that the Court, in equity, enter a decree allocating and directing the payment of the abated taxes, amounting to some \$17,000,000, to the plaintiff by way of mitigation of its losses in its subsidiary.

After many preliminary motions were made and disposed of, and after the filing of answers by the defendant and after pre-trial conferences, the cause finally came on for trial.

The trial itself consumed 13 days; the proceedings are set forth in 1700 pages of transcript; 14 witnesses testified and 164 exhibits, with various subdivisions, were introduced in evidence.

A number of special defenses were pleaded and testimony and exhibits offered at the trial in support thereof.

But I am of the opinion, in view of the fact that the cause is concededly of equitable cognizance, that decision must depend upon the essential righteousness of plaintiff's claim as an equitable demand.

Discussion

The income tax picture presented is bizarre indeed. It is "paradoxical" as the defendant's tax attorneys put it.⁵ The Western Pacific Railroad Company, the operating company, profitably conducted its railroad facilities in reorganization during 1942, 1943 and the forepart of 1944. Its own profit and loss records showed the debtor to be accountable to the United States in the sum of \$21,346,567 income taxes for the years 1942, 1943 and the first four months of 1944. During this same period of time the plaintiff was still the legal owner of all the capital stock of the debtor, an ownership which had been declared by both the Interstate Commerce Commission and the Reorganization Court to be valueless. But the tax attorneys for the defendant conceived a "paradoxical" plan. They

⁵ In a letter dated May 20, 1943 (plff. Ex. 50) addressed to Curry, Vice President of defendant company, tax counsel Polk set forth his idea of using the plaintiff's stock loss in the debtor to offset debtor's profits, saying: "This is commented upon rather than suggested, since it is paradoxical to compute a loss upon the operating company's stock which, through the mechanics of consolidated return reporting, could be used to nullify the very income of the affiliate whose stock had become worthless." (Interlineation supplied.)

decided that they would file, pursuant to Section 141 of the Internal Revenue Code and the Treasury Regulations issued thereunder⁶ affiliated or consolidated returns on behalf of the parent company and its subsidiaries and in them set up the plaintiff's stock loss (i.e., its ownership in the debtor) as an income tax deduction against the operating profits. Ostensibly they found their authority for so doing in Section 123 of the Revenue Act of 1942. (26 USC §23(g)4).⁷ Thus, part of the lost \$75,000,000 stockholding of the plaintiff in the debtor was applied as an offset to operating profits during each of the three years in question to the end that no part of the \$21,346,567 tax would be paid.

This was more than mere tax "saving"; it amounted to a complete tax "escape." But the debtor had already paid \$4,144,828 income taxes for the fiscal year 1942 and it had filed a claim for refund of such taxes upon the ground that it owed no taxes for 1942 if, on the theory of "carry-back," part of the \$75,000,000 stock loss was a proper deduction. So in order to make the far larger saving or "escape" offered for the three years in question, the claim for refund was waived and the Commissioner then accepted the returns for 1942-1943 and the fore part of 1944. The effect of this was that

⁶ § 141 Internal Rev. Code permits the filing of a consolidated return by affiliated corporations. Regulations 104 and 110 contain detailed requirements for such filing.

⁷ See footnote #3.

the debtor paid \$4,144,828 taxes to the United States in order to escape the \$21,346,567 previously mentioned, or a net saving or "escape" of \$17,201,739. To all of this the Commissioner agreed. It was stated to be a compromise because of some question as to the date of definite ascertainment of the stock loss. The Commissioner apparently agreed that, under the 1942 amendment (§23(g)4), it was proper to offset the capital stock loss against the net operating gain, and the taxpayer paid \$4,144,828 to resolve some alleged uncertainty as to the date of ascertainment of the stock loss.⁸

How the amendment to the statute, (§23(g)4), could have been availed of by the debtor is, mildly stated, puzzling, if not downright amazing. Its application in an orthodox case is understandable. The theory of deducting a loss in an economic aggregation of affiliated corporations, where one unit gains and the other unit loses, has been recognized and approved by Congress and the Courts.

Prior to the Revenue Act of 1938, losses resulting from the worthlessness of stocks and bonds were deductible from ordinary income and were not subject to the so-called capital-loss limitations. These limitations, that is that a capital loss could only offset a capital gain, had applied only to sales and

⁸ It is not at all clear to the Court how the alleged uncertainty as to the date of ascertainment of the stock loss, could have been a true factor affecting the tax settlement, inasmuch as any such uncertainty would, if it existed, as well apply with respect to the 1943 and 1944 returns.

exchanges, with the result that it was more advantageous to allow stocks, that might become worthless, to become worthless rather than to sell them. By the 1938 Act losses sustained by reason of the worthlessness of securities were treated as if they resulted from the sale or exchange of capital assets and thus were subject to the limitations applying to deductions in the form of capital losses. 26 USC 23(g)4, which was Section 123 of the Revenue Act of 1942, accorded losses on worthless stocks held by a taxpayer in affiliated corporations the same treatment accorded losses from all worthless securities prior to the Revenue Act of 1938.

Research does not disclose any statement of Congressional reason or purpose for the enactment of Section 123 of the Revenue Act of 1942 (26 USC 23(g)4. It was not in the original House Bill (H.R. 7378), but was an amendment added in the Senate (S. Rept. 1631, p. 89, 77th Cong. 2nd Sess.) Neither the Senator Report, nor the Conference Report of the Bill, H. Rept. 2586 (Cong. Rec. 77th Cong. 2nd Sess. p. 8401, 8441) state the reasons for the amendment. It is of interest that in the Revenue Act of 1942 (26 USC 117(i).) securities held by banks were accorded the same benefits as Section 123 accorded to affiliated corporations. While the purpose and intent of Congress has not anywhere been precisely stated, it is a fair and justifiable inference that the intent was to enlarge the general benefits afforded by consolidated or affiliated corporate returns.

It may be briefly stated that the philosophy of the consolidated return is to disregard the corporate entity and to tax as a single business or economic unit, what really is a business unit. This has been found to be sound, equitable and convenient tax procedure. It treats an affiliate group of corporations as one business enterprise, the various affiliates being considered as if they were branch offices of the main business establishment. The income from all units is considered as a single income, and the losses from all units, are treated as a single loss. See the following in this connection: Mertens, *Law of Federal Income Taxation*, (1942) Vol. 8, §46.01 and §46.02; Montgomery's *Federal Taxes—Corporations and Partnerships 1948-1949*, Vol. II, p. 678; Miller, "The Taxation of Intercompany Income;" *Law and Contemporary Problems*, 1940, Vol. 7, 301, 306; *Commerce Clearing House Standard Federal Tax Reporter*, 1949, Vol. 1, paragraph 200C-1. See also statement of the Acting Secretary of the Treasury, regarding the preliminary report of the Special Committee of the Committee on Ways and Means, 1933, p. 13.

In my opinion, it is crystal clear that in enacting Section 23(g)4, the Congress were merely furthering the general purposes and benefits of the statutory provisions allowing the filing of affiliated corporation returns. Obviously it intended by the provision, (23(g)4), to allow a parent company in an affiliated group, if its ownership of stock in a subsidiary becomes worthless, to offset it against other income of the parent company in any other subsidiaries or

subsidiary, in the same manner, as it had been permitted to offset operating losses in one subsidiary as against operating gains in another. To assume however that the Congress intended by 23(g)4 to statutorily authorize what was done in this case, is to attribute plain stupidity to the Congress of the United States—an unthinkable procedure, despite the general habit of criticism, both fair and unfair.

But here the inexplicable occurred. For \$4,144,828, the United States released \$21,346,567 in taxes upon a basis which is completely incomprehensible. The tax “escape” invites a type of scrutiny which this Court is powerless to give it.

Obviously the Court cannot pass judgment upon the validity of the tax compromise and settlement. It is now closed. It is final and cannot be reopened except for fraud.

I am not unmindful of the recognized and approved philosophy that a taxpayer may avail himself of every proper means of reducing his taxes.⁹ In every sense of the word, however, there was a real escape from the payment of taxes here. If I had the power, I would not hesitate to set aside the tax settlement. Indeed, if I could, I would order these taxes paid to the United States. That would effectively dispose of the cause.

⁹ U.S. v. Isham, 84 U.S. 496, 506; Jones v. Helvering App. D.C. 71 Fed. 2d 214, 217; Iowa Bridge Co. v. Commissioner, 8 Cir. 39 Fed. 2d 777; Commissioner v. Eldridge, 9 Cir. 79 Fed. 2d 629, 631; Mertens: Law of Fed. Taxation (1948) Vol. 10A § 61.06 at 249. Paul: Studies in Federal Taxation (1937) p. 104.

Perhaps it may be said that it is impertinent for the Court to concern itself with a closed tax transaction and agreement such as this. But if equity principles are our guide, then this tax settlement is of the web and woof of the issue to be decided. Equity has no precise boundaries, and certainly not in this unique controversy.

If this were an ordinary and more common type of tax saving, there might be impertinence to the Court's concern with it. But this so-called "saving" is inextricably entwined with the equities. Its very nature shapes and molds these equities. It is a "pot of honey equally attractive to principals and advocates."¹⁰ When equity is invoked to divide or distribute the "pot," it cannot be blindfolded as to the origin or nature of the "honey."

It is argued, in effect, by plaintiff that, irrespective of whether or not the tax settlement was in accord with the statute, nevertheless it is a completed transaction and a closed book and should have no place in the determination of the validity of plaintiff's cause of action. It is asserted that tax savings having been made, the only question remaining is whether or not on the record here, the defendant must turn over to plaintiff an amount equal to, or a substantial part of, the tax savings. But in my opinion, the tax escape was erroneous and unjust. It cannot be cured by committing the further inequity of distributing the gain thus made to others.

¹⁰ *Breving v. Lloyd Cuarto*, 84 Fed. Supp. 33, 35.

Debtor, having made good its "escape," now comes plaintiff and prays for a share, if not all, of that which "escaped." Whether there was, or was not, "duality of control" respecting the directorates of the two companies, appears to me to be not too important. True, there is a preponderance of the evidence in favor of the plaintiff's contention of "duality of control." Be that as it may, I am compelled to rest decision upon the fundamental issue of the justice and equity of plaintiff's right, if any, to be paid for that which was escaped. Analytically speaking, what the plaintiff seeks is to collect from the defendant an amount equal to all, or a substantial part of, taxes that the debtor did not pay to the United States.

What is the true nature of the claim of plaintiff and of the relief it seeks? What plaintiff really seeks is not all or a share of the so-called tax savings. Rather it is a circuitous way of obtaining something in the nature of equity or value for its ownership, rejected in the reorganization plan. Or put differently, it is an effort to share in the earnings of the debtor during the reorganization period. Essentially a so-called tax saving is but a different name for an earning. Assuming, *arguendo*, the validity of plaintiff's contention, its right or claim is dependent upon the debtor making earnings. If there were no earnings there could be no so-called tax saving. A "saving" in taxes is a negative concept. It is a benefit to one obligated to pay money, resulting from not having to pay. No benefit could

inure from participating in non-payment of an obligation, unless there rested upon the participant an obligation to pay. Absent such obligation, any sharing of that which is not paid out, would be gratuitous. In effect therefore, recognition of plaintiff's claim would be recognition of a right in plaintiff to share in debtor's earnings. As already stated, a demand substantially seeking this end was heretofore asserted by way of opposition to the plan and rejected. *Ecker v. Western Pac. Co.* 318 U.S. 448.

Not only that, but the philosophy underlying Section 77 of the Bankruptcy Act stands as a barrier against the equitable validity of plaintiff's claim in this cause. Rehabilitation of a debtor by readjusting its financial structure in the interest of the debtor, its creditors and the public, in a fair and equitable plan of reorganization, is the essential purpose of Section 77. If a debtor in fact has an equity, it is and should be recognized. If not, it is disregarded. Above all, Section 77 was devised to provide in the public interest both a speedy and efficient means of resuscitating, among others, sick and ailing railroads.

See: *Van Schaick v. McCarthy*, 10 Cir. 116 Fed. 2d 987, 992; *New England Coal & Coke Co. v. Rutland R. Co.* 2 Cir. 143 Fed. 2d 179, 185; *In re Denver & R.G.W.R. Co.*, 10 Cir. 150 Fed. 2d 28, 34; *Thompson v. State of Louisiana*, 8 Cir. 98 Fed. 2d 108, 110; Craven "The Judicial and Administrative Mechanism of Section 77," 1940, 7 Law and Contemporary Problems 464.

When it was finally determined, after running the full gamut of court and administrative procedure, in the reorganization of the Western Pacific Railroad Company, that the plaintiff's interest was worthless, nothing short of some extraordinary cause justifying reopening the reorganization proceeding could effect a change. To make any award in this cause, under the assumed authority of equity principles, would be in effect to modify the administrative and judicial judgments in the reorganization proceeding. Such a procedure would be an indirect nullification of the purpose of the reorganization statute, in the guise of an afterthought allegedly of equitable persuasion.

What was the actual result of the tax saving agreement by which it was determined that some \$21,000,000 in taxes were not due to the United States? Simply that the debtor did not pay taxes. It does not follow at all from this, that an obligation to pay the unpaid tax money, one to another, was thereby created.

The so-called "duality of control," much discussed and emphasized, is not important in resolving the tendered issue. For in the final analysis, plaintiff's hope to succeed here depends upon whether it could have lawfully acquired these unpaid tax monies by voluntary agreement between the directorates of the two companies. In my opinion, it could not. For such a procedure would violate and nullify the reorganization plan and the decree of the Court confirming it. It would permit

the plaintiff to share in the earnings of the debtor during the period of reorganization. Equity would aid the creditors of debtor to prevent it. Indeed there is some merit to defendant's contention that a firm obligation rested upon plaintiff to conform and cooperate to the end that the creditors and new owners should be benefited to the fullest.

What would be the result if the contention of plaintiff, that law and equity imposes an obligation upon defendant to pay the whole amount of unpaid tax money over to plaintiff, were sustained? It would mean a court order directing defendant to pay over to plaintiff an amount equal to the taxes the debtor should have paid to the United States. So the plaintiff, which formerly owned and was a failure in operating the debtor, would get from the defendant a sum of money out of debtor's earnings during reorganization equal to the taxes the debtor should have paid to the United States resulting from its profitable operations. In my opinion, such a whirligig rationale transcends all reasonable concepts of equity and justice.

An array of able counsel on both sides have put forth prodigious and ingenious efforts,¹¹ one side to retain the benefits of the tax "escape," and the

¹¹ In the preparation for the trial, and to develop the historical facts concerning the controversy and upon the subject of the so-called "duality of control," the depositions of 13 witnesses were taken over a period of many months and cover 6190 pages of transcript. Briefs, on submission of the cause, total 485 printed pages.

other to obtain them. And all the time the taxes escaped in reality belong to the United States.

The Court cannot cause these taxes to be paid, where they should be paid, to the United States. But, as between the parties, no persuasion of conscience or equity impels me to do otherwise than to leave the parties where they are, the defendant with its amazing and undeserved tax success; the plaintiff, as the reorganization decree left it, without interest in the debtor.

For the reasons stated, judgment will go for the defendant.¹²

Dated: September 6, 1949.

[Endorsed]: Filed September 6, 1949.

¹² Inasmuch as there is little factual dispute pertinent to the issue decided, this opinion may well serve, under the rules, so far as necessary, as findings of fact and conclusions of law. But counsel, if they wish, may submit findings pursuant to the Rules, provided they are limited to the issues involving the essential equitable considerations upon which the decision rests.

[Title of District Court and Cause.]

FINDINGS AND CONCLUSIONS
PROPOSED BY PLAINTIFF

Defendants having given notice under the stipulation and order of September 8, 1949, that they elected not to submit a draft of findings of fact and conclusions of law, plaintiff submits and proposes findings and conclusions as follows:

“Findings of Fact and Conclusions of Law

“The above-entitled cause having been duly tried before the Honorable Louis E. Goodman, District Judge, the court now makes the following

“Findings of Fact

* * *

“6. The offer of settlement made by defendant to the Commissioner of Internal Revenue, as stated in this Court’s opinion, was made in the plaintiff’s name but without its knowledge.

“7. Said offer of settlement was made in February, 1947. Subsequently defendant’s tax counsel first notified the plaintiff thereof. Thereafter plaintiff and defendant agreed upon a stipulation to be entered into in the present case in the form of plaintiff’s Exhibit 7. Thereupon the intervenors applied to the court herein for a temporary restraining order enjoining and restraining the plaintiff and defendant from consummating the proposed settlement. Upon the hearing of said application for

a restraining order defendant presented to the court the proposed stipulation referred to above, and after the hearing this Court, on August 29, 1947, made and entered its order in the form attached hereto. Thereafter said stipulation was signed by the parties and filed herein on September 5, 1947.

* * *

Conclusions of Law

“The court concludes as follows:

“By virtue of the stipulation filed herein on September 5, 1947, and this Court’s order of August 29, 1947, the sum of \$3,385,290.00 must be deemed to have been refunded to plaintiff by the Treasury Department in the ordinary course and manner prescribed by law and by the plaintiff paid into this Court. Said sum is now held by defendant as agent of the court. Defendant should be directed to return said sum of \$3,385,290.00 to the Clerk of this Court, and the Clerk should be directed to deliver said sum forthwith to the plaintiff in accordance with this Court’s opinion that the funds or tax savings resulting from the settlement with the government should be left with the party receiving the same; and the court further concludes that defendant should not be required to account to plaintiff for any tax savings not represented by refunds.”

By proposing the foregoing Findings and Conclusions plaintiff does not waive its claim that it is entitled also to judgment for tax savings not

represented by refunds, but it submits that upon the basis of the reasoning of the Court's opinion the Conclusions of Law proposed above necessarily follow.

Dated: November 3, 1949.

/s/ HERMAN PHLEGER,

/s/ MAURICE E. HARRISON,

/s/ MOSES LASKY,

BROBECK, PHLEGER AND
HARRISON,

/s/ FRANK C. NICODEMUS, JR.,

/s/ A. PERRY OSBORN,

/s/ MAHLON DICKERSON,

/s/ NORRIS DARRELL,

/s/ LeROY R. GOODRICH,

Attorneys for Plaintiff.

[Endorsed]: Filed November 4, 1949.

[Exhibit A attached to the preceding Proposed Findings of Facts and Conclusions of Law is identical to the Order Denying Temporary Restraining Order on Condition and Pretrial Order. See pages 163 to 167.]

[Title of District Court and Cause.]

NOTICE OF MOTION FOR REARGUMENT
AND TO AMEND FINDINGS OF FACT
AND CONCLUSIONS OF LAW APPEAR-
ING IN THE COURT'S OPINION FILED
SEPTEMBER 6, 1949.

To the above-named defendants, The Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway Company, Delta Finance Co., Ltd., and Standard Realty and Development Company, and Allen P. Matthew, Esq.; James D. Adams, Esq.; Robert L. Lipman, Esq., Burnham Enersen, Esq., Walker Lowry, Esq., and Messrs. McCutchen, Thomas, Matthew, Griffiths & Greene, Balfour Building, San Francisco, California, their attorneys; to the above-named defendant, Western Realty Company and Eugene M. Prince, Esq.; Everett A. Mathews, Esq.; Homer G. Angelo, Esq., and Messrs. Pillsbury, Madison & Sutro, 225 Bush Street, San Francisco, California, and A. Donald McKinnon, Esq., and Messrs. Milbank, Tweed, Hope & Hadley, 15 Broad Street, New York, New York, and Forbes D. Shaw, Esq., and Messrs. Whitman, Ransom, Coulson & Goetz, 40 Wall Street, New York, New York, its attorneys, and to the above-named plaintiff, The Western Pacific Railroad Corporation and Herman Phleger, Esq.; Maurice E. Harrison, Esq.; Moses Lasky, Esq., and Messrs. Brobeck,

Phleger & Harrison, 111 Sutter Street, San Francisco, California, and Messrs. Frank C. Nicodemus, Jr., A. Perry Osborn, Norris Darrell, Mahlon Dickerson and Leroy R. Goodrich, its attorneys:

You and Each of You Will Please Take Notice that on Monday, the 14th day of November, 1949, at the hour of 10:00 o'clock a.m. of said day, or as soon thereafter as counsel can be heard, at the courtroom of the above-entitled Court, the Honorable Louis E. Goodman presiding, in the United States Post Office Building, San Francisco, California, the undersigned will move said Court on behalf of the plaintiffs in intervention herein, Meredith H. Metzger, Henry Offerman and J. S. Farlee & Co., Inc., a corporation, for leave to re-argue this case and to amend and add to the findings of fact and conclusions of law appearing in the Court's opinion dated and filed herein on September 6, 1949, to require defendants to pay the sum of \$3,385,290.00 to the clerk of said Court and said clerk in turn to surrender possession of said sum and pay the same over to the plaintiff The Western Pacific Railroad Corporation as constituting the proceeds due plaintiff from the refund claim filed by it with the United States Government for the taxable year 1942 as reduced by settlement with the Government.

Said motion will be made on the grounds that on or about August 29, 1947, this Court made and entered its pretrial order herein based upon the

written stipulation of said plaintiff and defendants, as the condition for the denial by said Court of an application theretofore made by interveners for an order restraining the settlement with the United States Government of plaintiff's and defendants' tax liability on a consolidated basis for the taxable years 1942 and 1943 and the first four months of 1944, which pretrial order expressly provides that this Court shall determine the issues and give judgment herein in the same manner as if the tax savings for the year 1943 and first four months of 1944 had been allowed and said refund claim allowed and paid by the United States Government in the ordinary course and manner prescribed by law, to wit, to plaintiff in accordance with Treasury Department regulations 104 and 110, and as proportionately reduced by said settlement and which stipulation expressly provides that said refund claim as diminished by said settlement shall be deemed to have been allowed by the United States Government and paid to said plaintiff corporation as required by law and by said plaintiff paid into this Court; that in its said opinion made and filed herein on September 6, 1949, as aforesaid, the Court has announced its intention of leaving the parties where they are; that the proceeds from said refund claim as proportionately reduced by said settlement in accordance with said pretrial order and stipulation amount to the sum of \$3,385,290.00 and remain in the actual possession of defendants; and that in concluding in its

said opinion that defendants should have judgment herein without ordering the surrender of said sum of \$3,385,290.00 to the plaintiff corporation, the Court acted under a misapprehension of fact in that it overlooked and gave no effect whatsoever to its aforesaid pretrial order or to said stipulation.

Said motion will be further made and based upon this notice, upon the affidavit of Julius Levy, Esq., dated October 28, 1949, annexed hereto, the accompanying points and authorities and upon all the records, papers, pleadings and files in this action.

Dated: November 3, 1949.

WEBSTER V. CLARK,
ROGERS AND CLARK,
DAVID FREIDENRICH,
JULIUS LEVY,

By /s/ WEBSTER V. CLARK,

Attorneys for Meredith H. Metzger, Henry Offerman and J. S. Farlee & Co., Inc., a corporation, Plaintiffs in Intervention.

[Title of District Court and Cause.]

AFFIDAVIT OF JULIUS LEVY

Julius Levy, being duly sworn, deposes and says:

I am one of the attorneys for the plaintiffs-intervenors herein.

This affidavit is submitted in support of a motion for reargument and to amend the findings set forth in this Court's opinion dated September 6, 1949.

Basis for the Motion

In its opinion this Court, because it found the tax savings were "erroneous and unjust"—a tax "escape"—and "in reality" the property of the United States, concluded that equity must leave the parties "where they are."

The Court then proceeded to leave the parties where it believed they were—defendant with all and plaintiff with none, of the tax savings.

In so doing, we respectfully urge that the Court labored under a misapprehension of fact. It overlooks its own pretrial order (unmentioned in the opinion) entered on intervenors' motion to enjoin the tax settlement with the United States.

Plaintiff, in fact, as determined by that pretrial order, was in the position of having \$3,385,290 of the tax "escape." Therefore, to leave plaintiff where the Court found it, requires plaintiff to be left with \$3,385,290.

The Court's Order and Its Effect

During the pendency of this action, on August 25, 1947, the intervenors brought on a motion to enjoin the consummation of the then pending offer to settle with the United States Government. By that offer, the Government's total claim of \$21,000,000 covering the 1942 refund claim and the

years 1943 and part of 1944, were to be settled for approximately \$4,000,000. The suggested mechanics for accomplishing this result were for the Government to accept the 1943 and 1944 returns as filed and to reject the refund claim.

But for the settlement, the refund claim, if eventually approved, would have been paid by the United States to the plaintiff; plaintiff would have had possession of those tax savings. Similarly, if the 1943 and 1944 returns were accepted, defendant which had paid no taxes for those years, would remain in possession of those tax savings. However, the proposed settlement, if consummated without more, would deprive plaintiff of possession of any part of the tax savings—its refund claim was being waived—and it would give to defendant sole possession of all of the tax savings.

We sought to enjoin the settlement solely because its form would prejudice plaintiff's rights in this very litigation.

We urged that the settlement's failure to continue plaintiff's normal right to possession of a part of the savings would seriously prejudice plaintiff's rights in this litigation. Defendant's defenses of limitation, laches, etc., heretofore sufficient (if sustained) merely to defeat plaintiff's claim to savings in defendants' possession but without force to determine plaintiff's right to retain tax savings in plaintiff's possession, would, if the settlement were put through in the contemplated form, operate to defeat plaintiff's entire claim in the action

since defendant alone would possess all the savings. The importance of possession was emphasized by defendants' answer; for before the settlement, it pleaded a counterclaim to recover from plaintiff the proceeds of the refund claim when, as and if it came into plaintiff's possession (Answer, par. V).

Over and above the prejudice foreseeable from the contents of the pleadings, we urged and hypothesized that this Court might very well conclude, for one reason or another, to leave the parties where it found them; and, again, it would be of the greatest importance for plaintiff to have possession of so much of the tax savings as would normally come into its possession. For all of these reasons, we contended that the form of the settlement should not alter the normal status quo of the parties to this litigation. We suggested an easy and effective expedient for preventing the settlement from divesting plaintiff of possession of about \$3,000,000 of tax savings, i.e.: The parties should by agreement give plaintiff possession of the refund claim proceeds pro tanto reduced by the settlement and permit defendant to retain possession of the remaining tax savings similarly reduced. Both parties could then litigate their title to the tax savings in this action unaffected and unprejudiced by changes in possession produced solely by the form of any settlement with the United States Government.

This Court thereupon entered the following order designed to accomplish this very result:

“It Is Hereby Ordered:

“(1) That the application of interveners for a restraining order be and the same is hereby denied upon the condition that the defendants shall enter into a stipulation with the plaintiff in the form annexed hereto marked Exhibit A; and upon the further condition that said hearing upon said application of interveners shall be deemed a pretrial hearing on the aforesaid issues as if properly noticed as such so that the Court may make and enter an appropriate pretrial order pursuant thereto; and

“(2) That the aforesaid settlement with the United States Government shall have force and effect in this action and as between the parties hereto solely to the extent that it reduces pro tanto the total amount in controversy herein and that in all other respects this Court shall and does hereby preserve the respective rights and positions of all parties and shall determine the issues and give judgment herein, in the same manner as if said tax saving and been allowed and said refund claim allowed and paid by the United States Government in the ordinary course and manner prescribed by law and as proportionately reduced by said settlement.”

By its unequivocal language clearly reflecting the parties' intention, this order expressly fixes the

parties' "positions," i.e., plaintiff is put in the position of having the reduced refund proceeds and the stipulation, Exhibit "A," deems these very funds "paid to the plaintiff * * * and by the plaintiff paid into court." The order then requires the court to determine the "issues" and to render the "judgment" on the basis of that clearly stated position of plaintiff.

Hence this Court, to leave the parties "where they are," must in its final judgment leave the plaintiff with the reduced refund proceeds of \$3,385,290, and the defendants with the balance. Anything else would make both the parties' stipulation and the Court's order a mockery and a meaningless gesture which had served merely to engender misplaced reliance.

We have not sought to answer any contentions bearing on the rights of the parties inter sese. This Court has cut short any such inquiry by its conclusion that, because of the contaminated origin of the tax savings, it will leave the parties "where they are." It has thereby rendered immaterial whatever may have been the rights of the parties inter sese, if this Court were disposed to determine them. For, as this Court stated, the evil of the savings' origin "cannot be cured by committing the further inequity of distributing the gain thus made to others" (Op. 14).

We therefore submit that reargument should be granted and this Court's opinion amended to require defendants to pay \$3,385,290 to the Clerk

of the Court and the Clerk, in turn, to surrender its possession to the plaintiff.

/s/ JULIUS LEVY.

Sworn to before me this 28th day of October, 1949.

/s/ ETHEL RADIN,

Notary Public in the State
of New York.

[Endorsed]: Filed November 4, 1949.

[Title of District Court and Cause.]

NOTICE OF MOTION OF PLAINTIFF AND
OF ALEXIS I. duP. BAYARD, RECEIVER,
TO JOIN RECEIVER AS PARTY PLAINTIFF
UNDER RULE 25(c) R.C.P.

To defendants, The Western Pacific Railroad Company, Sacramento Northern Railway, Deep Creek Railroad Company, Standard Realty and Development Company, Tidewater Southern Railway,

and to their attorneys, Allen P. Matthew, Esq.; James Adams, Esq.; Robert L. Lipman, Esq.; Burnham Enersen, Esq.; Walker Lowry, Esq., and Messrs. McCutchen, Thomas, Matthew, Griffiths & Greene;

To defendant, Western Realty Company, and to its attorneys Everett A. Matthews, Esq.; Messrs.

Pillsbury, Madison & Sutro, J. Donald MacKinnon, Esq.; Messrs. Milbank, Tweed, Hope & Hadley; Forbes D. Shaw, Esq., and Messrs. Whitman, Ransom, Coulson & Goetz;

To plaintiffs in intervention, Russell M. Van Kirk, Henry Offerman and J. S. Farlee & Co., Inc., and to their attorneys, Messrs. Rogers and Clark, Webster V. Clark, Esq.; David Freidenrich, Esq.; Julius Levy, Esq.; Messrs. Pomerantz, Levy, Schreiber & Haudek, and Abraham L. Pomerantz, Esq.

Please Take Notice, hereby given, that on Monday, the 21st day of November, 1949, at the hour of 10 o'clock a.m. or as soon thereafter as counsel can be heard, in the courtroom of the above-entitled court, in the Post Office Building, in the City and County of San Francisco, before the Honorable Louis E. Goodman, District Judge, the plaintiff and Alexis I. duP. Bayard, as Receiver of the plaintiff, will move the court for an order directing said Alexis I. duP. Bayard, as such Receiver, to be joined as party plaintiff herein.

This motion will be made on the following grounds: An order was made and entered by the Court of Chancery of the State of Delaware in and for New Castle County appointing Alexis I. duP. Bayard as Receiver of plaintiff, The Western Pacific Railroad Corporation, to take charge of its estate and effects and to collect the debts and properties due and belonging to it with power to enter his appearance in, and to prosecute and defend

in its name or otherwise, all suits and proceedings which may be necessary or proper for said purpose, including the instant action; Exhibit A hereto attached is a certified copy of said order. Said order was issued in a certain suit instituted by the filing of a petition by the Attorney General of the State of Delaware on October 19, 1949, wherein an answer by the defendant therein, the plaintiff in the present action, was filed the same day; Exhibits B and C attached hereto are certified copies of said complaint and answer, respectively. On Wednesday, the Nineteenth day of October, 1949, said Alexis I. duP. Bayard duly qualified as said receiver by executing and filing in the office of the Register of said Chancery Court a bond in the form and amount as specified in said order, as shown by the affidavit of said Alexis I. duP. Bayard hereto attached as Exhibit D.

Said motion will be based on this notice of motion, the four exhibits hereto attached, and on all pleadings and papers on file herein.

Dated: November 14, 1949.

HERMAN PHLEGER,

MAURICE E. HARRISON,

MOSES LASKY,

BROBECK, PHLEGER AND
HARRISON.

By /s/ FRANK C. NICODEMUS, JR.

EXHIBIT "A"

In the Court of Chancery of the State of Delaware
In and for New Castle County

Civic Action No. 131

ALBERT W. JAMES, Attorney General of the
State of Delaware, ex rel LAWRENCE O.
ROSS,

vs.

THE WESTERN PACIFIC RAILROAD COR-
PORATION, a Corporation of the State of
Delaware.

ORDER

And Now To Wit this 19th day of October, 1949, the complaint of Albert W. James, Attorney General of the State of Delaware, ex rel Lawrence O. Ross, praying for the appointment of a trustee or trustees of said defendant corporation, having been presented, read and maturely considered together with the answer to said complaint, filed on behalf of said corporation, admitting the allegations of said complaint and consenting to its prayers; and

It appearing to the Court that it would be to the best interest of the corporation and the stockholders thereof, that the relief prayed for be granted, it is on motion of the plaintiff found by the Chancellor that there has been a failure of defendant's primary corporate purpose and/or

abuse, misuse or nonuse of its corporate powers, privileges or franchises; and it is ordered by the Chancellor:

1. That the defendant be and it is hereby placed in the judicial custody of this Court for liquidation and dissolution.

2. That Alexis I. duP. Bayard of the County of New Castle and State of Delaware, be and he is hereby appointed receiver of the defendant corporation to take charge of the estate and effects of said corporation and to collect the debts and properties due and belonging to said corporation with power to enter his appearance in and to prosecute and defend in the name of said corporation or otherwise, all suits and proceedings which may be necessary or proper for the purpose aforesaid, including the three causes of action referred to in paragraph 8 of the complaint, and to appoint an agent or agents under him and to select attorneys to represent him and to do all other acts which might be done by said corporation, if in being, that may be necessary for the final settlement and liquidation of the affairs of said corporation.

3. That said receiver herein appointed shall execute and file in the office of the Register of this Court, a bond in the usual form with surety to be approved by the Chancellor in the penal sum of Five Thousand Dollars (\$5,000.00) conditioned on the faithful performance of his duties as receiver in this proceeding and for the proper accounting

to the Court for any moneys and property that may come into his hands as such receiver; provided that said receiver shall deposit all negotiable securities and all cash assets in the Wilmington Trust Company of Wilmington, Delaware.

4. That United States Fidelity and Guaranty Company, a corporation of the State of Maryland, be and it is hereby approved as surety upon the bond of the receiver herein appointed.

/s/ COLLINS J. SEITZ,
Vice-Chancellor.

EXHIBIT "B"

In the Court of Chancery of the State of Delaware
In and for New Castle County

Civil Action No. 131

ALBERT W. JAMES, Attorney General of the
State of Delaware, ex rel LAWRENCE O.
ROSS,

vs.

THE WESTERN PACIFIC RAILROAD COR-
PORATION, a Corporation of the State of
Delaware.

COMPLAINT

The complaint of Albert W. James, Attorney General of the State of Delaware, ex rel Lawrence O. Ross respectfully shows to the Chancellor as follows:

1. Relator, Lawrence O. Ross, whose address is 64-15A 186th Lane, Flushing, New York, is the registered holder and owner of 3,600 shares of preferred stock out of a total of 400,000 shares outstanding of the defendant corporation. He is associated with and is working cooperatively with a group of stockholders whose holdings of preferred stock of the defendant corporation are substantial. There are also outstanding 600,000 shares of common stock of the defendant corporation.

2. The defendant, which is not a corporation for public improvement, was duly incorporated under the laws of the State of Delaware on June 29, 1916, for the primary purpose of acquiring all of the capital stock of The Western Pacific Railroad Company, a railroad company owning lines of railroad lying in the states of Utah, Nevada and California, and constituting a single line of railway from Oakland, California, to Salt Lake City, Utah. The defendant has its principal office in the City of Wilmington, County of New Castle and State of Delaware.

3. This is an action brought under Section 68 of the Delaware Corporation Law, which vests in the Court of Chancery jurisdiction to revoke or forfeit charters of corporations organized under the laws of the State of Delaware for "abuse, misuse or nonuse of their corporate powers, privileges or franchises." There is also invoked the general equity power of this Court to take jurisdiction of a corporation, the primary corporate

purpose of which has failed, and which is unable to meet its debts as they mature. The relief sought by this complaint is the revocation of defendant's corporate charter and the appointment of a trustee or trustees to administer and eventually to windup the affairs of the corporation, under the guidance of this Honorable Court.

* * *

6. As a consequence of the two reorganization proceedings referred to above which denuded The Western Pacific Railroad Corporation of its entire stock investment in The Western Pacific Railroad Company and the Denver and Rio Grande Western Railroad Company, the defendant corporation virtually ceased to exist and the corporate purpose for which it was organized failed. Nothing remains for The Western Pacific Railroad Corporation to do other than to collect and distribute its assets to its stockholders.¹ The defendant corporation has not paid the Delaware Corporation Franchise Tax for the years 1947 and 1948 and the tax for several preceding years was accepted by the State of Delaware on a partial basis because of the failure of the corporation to perform the functions for which it was created. It is recognized that defendant's corporate charter, in the absence of

¹The defendant corporation has outstanding 400,000 shares of preferred stock having a par value of \$100 per share. Under no circumstances can the common stockholders hope to receive any liquidating dividend on the 600,000 shares of common stock also outstanding.

earlier action by this Court, would not be forfeited until April 1, 1950, through failure to pay the Delaware Franchise Tax; nonetheless, the defendant has not operated within the purview of its corporate powers for many years. In view of the circumstances hereinabove and hereinafter recited, any additional payment of franchise taxes would constitute a waste of funds available for distribution to its stockholders.

7. After the aforesaid order of the Supreme Court of March, 1943, in *Ecker v. Western Pacific Railroad Corporation*, supra, the defendant corporation faced with complete financial collapse, fell into a state of corporate coma, and what corporate activities were engaged in by the defendant were directed and controlled by The Western Pacific Railroad Company for its own interests and purposes, and not for the purposes for which the defendant was intended. Defendant's corporate existence was maintained during the critical tax period at the direction and insistence of tax counsel for The Western Pacific Railroad Company which took over and used the tremendous stock loss sustained by the defendant corporation in an amount of more than \$75,000,000, as an offset against taxes due on its own substantial operating income. As of the spring of 1943, the defendant corporation was virtually without liquid assets. In June of 1943, it ceased to pay any office expenses or to pay any compensation to its officers and employees. Its officers and employees and all of its office expenses

were paid by its subsidiary company, The Western Pacific Railroad Company. After June 1, 1943, the defendant corporation had only one officer, a Mr. Michael J. Curry, who had been the corporation's chief clerk, and who was paid, as were its other employees, by The Western Pacific Railroad Company. This state of affairs continued until May 1, 1945, since which date defendant's remaining personnel have been compensated by tax counsel for The Western Pacific Railroad Company. Having come to the conclusion that it was possible under the Internal Revenue Law to offset the loss of the holding company against the income of the operating company, it is apparent that the defendant corporation was kept in being by counsel and officers of the operating company solely for the purpose of discharging the tax liability of the operating company through the use of the defendant corporation's operating losses and other tax credits. At no time during this period were the directors² of the defendant corporation advised as to what were the rights of the defendant corporation in connection with the filing of consolidated returns.

²From June 1, 1943, until suit by the present defendant against The Western Pacific Railroad Company for unjust enrichment was filed in California in October, 1946, nine persons were at one time or another directors of the defendant corporation. Only three were not employees of The Western Pacific Railroad Company, and one was not only a director of the subsidiary but was chairman of that company's executive committee and one of its trustees in bankruptcy.

After negotiations with the Government were initiated in regards to acceptance of consolidated returns, Mr. Curry, at the request of Mr. James K. Polk, counsel for The Western Pacific Railroad Company, gave him a power of attorney to act for the defendant corporation in settlement negotiations, but neither Mr. Curry nor the directors of the corporation were informed about the ultimate purpose of the power of attorney. Finally, in June of 1946, a stockholders' bill was filed in New York by certain of the defendant's stockholders, as a result of which the directors of the defendant corporation elected in 1944, learned for the first time that the stock loss sustained by the defendant corporation had been utilized by The Western Pacific Railroad Company on consolidated tax returns for the years 1942, 1943 and the first four months of 1944, whereupon on October 10, 1946, suit in the District Court in California was instituted by the present defendant, at the instance of a revitalized board of directors.

8. The only assets remaining in the hands of The Western Pacific Railroad Corporation in addition to a small amount of cash, namely, a sum not in excess of \$5,000, are the following causes of action which are now pending as hereinafter set forth:

a) The suit in the United States District Court for the Northern District of California, Southern Division, hereinbefore referred to, wherein the present defendant corporation seeks to recover all or

part of the \$17,500,000 tax saving unjustifiably gained by The Western Pacific Railroad Company through a taking over of all of the defendant's stock loss of \$75,000,000. On September 6, 1949, Judge Goodman filed an opinion in this cause directing that judgment would be entered for the defendant, The Western Pacific Railroad Company. A copy of this opinion is attached hereto and marked Exhibit "A."

* * *

Until the present time, the present board of directors of the defendant corporation, has diligently sought to protect the interests of all of the stockholders of the defendant corporation and to recover for them some part of the enormous sums lost by them in the bankruptcy of The Western Pacific Railroad Company and The Denver and Rio Grande Western Railroad Company.

9. In each of the above-referred-to actions, however, the defendant corporation is faced with important decisions. In the action pending in the District Court of California against The Western Pacific Railroad Company, there is the immediate problem as to whether an appeal should be prosecuted or whether discussions should be entered into with The Western Pacific Railroad Company with a view to a negotiated settlement. Similarly, in the other two pending actions, the defendant corporation is faced with the problem of deciding whether diligent efforts should be maintained to bring said actions to final conclusion either by trial or negotia-

tion. For all of the foregoing reasons the present board of directors of the defendant corporation having no recent mandate from stockholders of the defendant corporation and being under constant pressure for moneys wherewith to prosecute the pending litigations is in no position to assume responsibility for the determination of these many serious problems without the aid and guidance of this Court. It is likewise unclear in the event that these problems were to be submitted to the stockholders of the defendant corporation for their approval or disapproval, whether the vote of a majority of such stockholders would bind a dissenting minority.

Moreover, the defendant corporation although confident of substantial realizations in some one or more of the pending litigations, particularly the litigation instituted in California on October 10, 1946, as hereinbefore alleged, which counsel believe is strengthened rather than weakened by the annexed opinion of Judge Goodman because of his factual finding that the operating company has been unjustly enriched to the extent of \$17,500,000, which unjust enrichment was due wholly to the extraordinary losses and the tax credits of the defendant corporation, it is nevertheless under serious financial handicaps in meeting essential expense in connection with the prosecution of its just claims.

* * *

10. Under the circumstances, there is no alternative to a prompt and equitable solution to these

problems other than the voiding of the corporate charter of the defendant corporation and the appointment of a trustee or receiver to act for the corporation under the aid and guidance of this Honorable Court in disposing of the above-recited matters as well as in effecting a gradual liquidation of said corporation.

Wherefore, plaintiff, ex rel Lawrence O. Ross, prays as follows:

1) That this Court decree that there has been a failure of defendant's primary corporate purpose and/or abuse, misuse or nonuse of its corporate powers, privileges or franchises.

2) That an order be entered directing that the corporate existence of the defendant be dissolved.

3) In aid of the relief above prayed for, that the board of directors or an appropriate committee thereof or such person or persons as this Honorable Court shall select be appointed liquidating trustee or trustees with all of the powers of equity receivers, including, inter alia, the power under order of this Court, to prosecute in the name of the defendant corporation the three causes of action set forth in paragraph 8 of this complaint and all other proper claims and demands whether of a legal or of an equitable nature in any court of competent jurisdiction against all persons and corporations obligated to the defendant, the power to compromise claims of the defendant against all persons and corporations obligated to the defendant, the power to

defend the corporation against claims of alleged creditors and others, and the power to distribute to those entitled thereto, the assets of the defendant corporation as shall be directed by this Honorable Court.

4) That the defendant corporation, its officers, directors, agents, attorneys and employees, be ordered to deliver to said trustee or trustees, all property of every kind and description and all books of account, papers and documents, belonging to or in anywise pertaining to the defendant corporation or its business.

5) That pending final determination of this cause, that a trustee or trustees pendente lite be appointed by order of this Honorable Court to take charge of and to protect and safeguard, pursuant to Court order, the property and assets of the defendant corporation.

6) That plaintiff, ex rel Lawrence O. Ross, may have such other and further relief as the nature of the cause may require or as the Chancellor may deem equitable, just and proper in the premises.

/s/ ALBERT W. JAMES,
Attorney General,
State of Delaware.

/s/ DANIEL L. HERRMANN,
Attorney for Relator.

State of Delaware,
New Castle County—ss.

Be It Remembered that on this 13th day of October, 1949, personally came before me the Subscriber, a Notary Public for the State and County aforesaid, Albert W. James, Attorney General of the State of Delaware, who, being by me duly sworn according to law, did depose and say that the matter contained in the foregoing bill of complaint is true insofar as it concerns his act and deed and insofar as it relates to the act and deed of any other person is believed by him to be true.

/s/ ALBERT W. JAMES.

Sworn to and subscribed before me, the day and year first above written.

[Seal] /s/ JOHN L. MALONE,
Notary Public.

[Exhibit A-1 attached to the preceding document is identical to the Opinion set out on pages 258 to 279.]

[Title of District Court and Cause.]

DEFENDANTS' OBJECTIONS TO FINDINGS
AND CONCLUSIONS PROPOSED BY
PLAINTIFF

I.

Defendants object to each of plaintiff's proposed findings of fact on the following grounds:

1. The proposed findings are not "limited to the issues involving the essential equitable considerations upon which the decision rests." For the most part they relate to "duality of control," which the Court held "is not important," and despite the fact that the Court rested its decision "upon the fundamental issue of the justice and equity of plaintiff's right."

2. The proposed findings are, on the undisputed evidence, erroneous in many particulars, as set forth below.

II.

(a) Plaintiff's proposed finding No. 2 reads:

"2. The consolidated returns for 1942, 1943 and the first four months of 1944, and the claim for refund were filed, respectively, May 15, 1943; July 15, 1944, and June 15, 1945, and March 9, 1945. The return for the first four months of 1944 and the claim for refund were filed by the defendant; the returns for 1942 and 1943 were filed by the debtor."

The first sentence is accurate. The second sentence to be accurate should read:

“The consolidated returns for 1942 and 1943 and the consolidated return which included the first four months of 1944 were each signed and filed by plaintiff’s president, and the refund claim for 1942 was signed by plaintiff’s president and filed by tax counsel for the affiliated group.”

(See as to the signing and filing of the 1942 return, R. 320, 542, 551-52; of the 1943 return, R. 322, 365; of the 1944 return, R. 324; of the refund claim, R. 325, 1307, 1339-40. As to the status of Mr. Polk as counsel for the group, -see R. 1287, 1321-22, 1071, 1115.)

(b) Plaintiff’s proposed finding No. 3 reads:

“3. At all times herein referred to the plaintiff’s president, who signed the said returns and the claim for refund, was defendant’s vice-president and employee,* and at the time when he signed the return for the first four months of 1944 and the power of attorney referred to in paragraph 5 below he was in the paid retainer of defendants’ tax counsel.”

This statement to be accurate should read:

“Plaintiff’s president, Michael J. Curry, signed the said returns and the claim for refund. On May 15, 1943, the date of the 1942 return, Mr.

*In its proposed findings plaintiff has frequently failed to distinguish between the railroad company prior to reorganization, the reorganization trustees and the reorganized railroad company. Only the latter may be correctly designated as defendant.

Curry was both plaintiff's president and a vice-president of the debtor in reorganization. His salary was then paid in part by plaintiff and in part by the reorganization trustees. On July 15, 1944, the date of the 1943 return, Mr. Curry was both president of plaintiff and vice-president of the debtor in reorganization. His salary was paid in its entirety by the reorganization trustees who, pursuant to the request of plaintiff, had agreed to pay the expenses of the New York office. On March 9, 1945, the date of the refund claim, Mr. Curry was both president of plaintiff and a vice-president of the reorganized The Western Pacific Railroad Company and his salary was paid by that company. On June 15, 1945, the date of the 1944 return, Mr. Curry was president of plaintiff. He then held no office with and was receiving no salary from the reorganized The Western Pacific Railroad Company, but he was receiving a retainer from the law firm of Whitman, Ransom, Coulson & Goetz, which had been employed as tax counsel by the reorganization trustees and whose employment for tax purposes was continued by defendant, the reorganized company."

(See as to Mr. Curry's positions and compensation on May 15, 1943, R.P.Exs. 21, 23, 25, 293-4, 499; on July 15, 1944, R.P.Ex. 21, 23, 25, 293-4, 316; on March 9, 1945, R.P.Exs. 21, 23, 25, 293-4; on June 15, 1945, R.P.Ex. 21, 23, 25, 33, 307-8, 310, 646-47; on the employment of tax counsel, R.P.Ex. 39 A/F, 884,

1071, 1115; on the arrangement for the trustees to pay the expenses of the New York office, R. 1082, 1094-95 and P.Ex. 30.)

(c) Plaintiff's proposed finding No. 4 reads:

"4. Plaintiff did not know until June, 1946, that the debtor had used plaintiff's stock loss in the consolidated returns for 1942 and 1943, or that defendant had used plaintiff's stock loss in the consolidated return for the forepart of 1944 or in a claim for refund."

This statement to be accurate should read:

"Plaintiff's president knew that plaintiff's stock loss had been used in the consolidated returns and in the claim for refund on or before the respective dates on which those returns and the claim for refund were signed by him, and as long as plaintiff maintained an office, the tax returns were prepared in that office by plaintiff's employees. The handling of the tax transactions was discussed in the annual reports published by the reorganization trustees for 1943 on May 1, 1944, for 1944 on May 1, 1945, and by the reorganized The Western Pacific Railroad Company for 1945 on April 1, 1946. Copies of the 1943 report were furnished to plaintiff on June 28, 1944, of the 1944 report in mid 1945. Moreover, on February 21, 1945, plaintiff's president wrote to F. C. Nicodemus, Jr., who was then plaintiff's counsel and who is an attorney for plaintiff in this action, explaining the use of plaintiff's stock loss in the returns for 1942 and

1943 and the proposed use of the stock loss in the 1942 refund claim and the 1944 return. The Court finds that nothing was concealed from plaintiff and that plaintiff either knew or had ample opportunity to know all the facts concerning the tax transactions.”

(See as to Mr. Curry’s information as to the use of the stock loss in the tax returns and refund claim on the dates they were filed, R. 342-43, 365-68, and 604; as to the preparation of the returns in plaintiff’s office, R. 320, 540-41, 1291, 921; as to the annual reports, R. 367-68, 891, and their delivery to plaintiff, R. 1130, 1132; and as to the letter from Mr. Curry to Mr. Nicodemus, Exhibit In. 5; see, in addition, D. Ex. 9, 13, 16, 28, 37-A, 56, and R. 809-12, 887-890, 960, 946, 1048-49, as to the information of the plaintiff’s officers, directors and counsel.)

(d) Plaintiff’s proposed finding No. 5 reads:

“5. In June, 1946, defendant’s tax counsel caused plaintiff’s president to sign in its name a power of attorney to them to represent it in all matters before the Treasury Department and the Bureau of Internal Revenue relating to any matter involving Federal income tax for the years here involved. This power of attorney was signed by plaintiff’s president without consulting plaintiff’s board of directors and without its knowledge. After obtaining it, defendant’s tax counsel

conducted all negotiations for a settlement in the name of the plaintiff under this power of attorney and on behalf of defendant and with its knowledge.”

This statement to be accurate should read:

“In June, 1946, plaintiff’s president, at the request of James K. Polk, acting as counsel for the affiliated group, signed on behalf of plaintiff a power of attorney authorizing Mr. Polk and his associates to represent plaintiff in all matters before the Treasury Department and the Bureau of Internal Revenue relating to Federal income taxes for the years here involved. Similar powers of attorney were obtained from all other group members. The power of attorney from plaintiff was signed by plaintiff’s president in the ordinary course of business and without consulting plaintiff’s board of directors. In September, 1946, plaintiff recognized and approved the activities of Mr. Polk on its behalf in connection with tax affairs. After Mr. Polk and his associates obtained powers of attorney from the group members, they conducted the negotiations for settlement in the tax controversy in the name of the plaintiff, as the Treasury Regulations require, and on behalf of the group. The reorganization trustees, and after December 31, 1944, the officers of the reorganized The Western Pacific Railroad Company, were informed of all important developments concerning the negotiations for settlement.”

(See as to the circumstances under which the power of attorney was obtained from plaintiff, R. 326; as to the powers of attorney from the other group members, R. 1313; for the text of these powers of attorney, Exhibits In. Ex. 13, P. Ex. 65; as to the negotiations with the Bureau of Internal Revenue, R. 1308-09, 1312-19, and Exhibits In. 14, P. 64, P. 71; as to plaintiff's September, 1946, approval of Mr. Polk's tax work, Exhibit D-37A.)

(e) Plaintiff's proposed finding No. 6 reads:

"6. The offer of settlement made by defendant to the Commissioner of Internal Revenue, as stated in this Court's opinion, was made in the plaintiff's name but without its knowledge."

This statement to be accurate should read:

"The offer of settlement made by tax counsel to the Commissioner of Internal Revenue to settle the tax liability of the group for the years here in question was made on behalf of the group and in plaintiff's name, as the Treasury Regulations require, and without prior consultation with plaintiff."

(See as to the circumstances of the offer of settlement and its terms, R. 1339-40 and Exhibit In. 14.)

(f) Plaintiff's proposed finding No. 7 reads:

"7. Said offer of settlement was made in February, 1947. Subsequently defendant's tax counsel

first notified the plaintiff thereof. Thereafter plaintiff and defendant agreed upon a stipulation to be entered into in the present case in the form of plaintiff's Exhibit 7. Thereupon the intervenors applied to the court herein for a temporary restraining order enjoining and restraining the plaintiff and defendant from consummating the proposed settlement. Upon the hearing of said application for a restraining order defendant presented to the court the proposed stipulation referred to above, and after the hearing this Court, on August 29, 1947, made and entered its order in the form attached hereto. Thereafter, said stipulation was signed by the parties and filed herein on September 5, 1947."

This statement to be accurate should read:

"Said offer of settlement was made February 11, 1947. On April 2, 1947, tax counsel notified plaintiff in writing of the offer of settlement and advised plaintiff of its right to withdraw the offer at any time prior to its acceptance by the Commissioner of Internal Revenue. Plaintiff threatened to revoke the power of attorney of tax counsel and to withdraw the offer of settlement but following conferences between counsel, a stipulation was agreed upon (Plaintiff's Exhibit 7). The intervenors applied to this Court for a temporary restraining order to enjoin the completion of the settlement. A hearing was held on the application on August 26 and 27, 1947, and an order entered

denying the application. The stipulation of the parties was signed and filed on September 5, 1947.”

(See as to the date of the offer of settlement, Exhibit In. 14; as to the date and terms of the notification to plaintiff, Exhibit P. 68, and as to the terms of the stipulation, Plaintiff’s Exhibit 7.)

(g) Plaintiff’s proposed finding No. 8 reads:

“8. The settlement with the Bureau of Internal Revenue was not entered into in the manner prescribed by Section 3761 of the Internal Revenue Code. In carrying out the settlement the claim for refund was not withdrawn, as stated in the opinion, but the Bureau of Internal Revenue gave notice of its disallowance of the claim for refund and placed the returns for 1942, 1943 and the first four months of 1944 in its closed files. The statute of limitations did not thereafter run until August 26, 1949 (eleven days before the rendition by this Court of its opinion herein) against an action against the Commissioner of Internal Revenue to enforce the claim for refund, but by reason of the settlement agreement no such action was instituted. The statute of limitations did not run against imposition of a deficiency assessment for 1943 taxes until June 10, 1948, or against the imposition of a deficiency assessment for 1944 taxes until June 15, 1948, but by reason of said settlement the Commissioner of Internal Revenue made no deficiency assessment.”

This statement to be accurate should read:

“The settlement was effected on the basis of the offer contained in tax counsel’s letter to the Commissioner of Internal Revenue dated February 11, 1947 (In Ex. 14), and the tax liabilities of the affiliated group for the period from 1942 to and including the first four months of 1944 were settled and determined on the basis of the returns as filed.”

(See as to the terms of the settlement, Exhibit In. 14, P. 7 (Ex. A. thereof.))

The statements contained in proposed finding No. 8 as to section 3761 of the Internal Revenue Code and as to periods of limitation are not statements of fact. They are conclusions of law on questions which have never been presented to this Court for decision. Nor is there any evidence whatever in the record as to why no deficiency assessments were made or proceedings taken on the claim for refund. The settlement made such proceedings unnecessary and defendants suggest that findings should not be made on questions which were not before the Court at the trial, on which no evidence has been presented and which are irrelevant.

(h) Plaintiff’s proposed finding No. 9 reads:

“9. Plaintiff at no time had any conferences, discussions or communications with the Bureau of Internal Revenue or any officer or agent thereof

relative to the returns, claim for refund or settlement.”

This statement to be accurate should read:

“All negotiations, conferences, discussions, and communications with the Bureau of Internal Revenue in connection with the returns, the claim for refund and the settlement were conducted by tax counsel. All the parties to this action approved the tax settlement.”

(See as to the negotiations with the Bureau of Internal Revenue, R. 1308-9, 1312-19, and Exhibits In. 14, P. 64, P. 71; and as to plaintiff's approval of the settlement R. 914 and Exhibit P. 69.)

(i) Plaintiff's proposed finding No. 10 reads:

“10. The evidence discloses no fraud committed by defendant's tax attorneys on the Bureau of Internal Revenue in connection with said tax settlement. The Bureau of Internal Revenue was motivated in agreeing to the settlement by its judgment as to the propriety of the claim for refund and of the tax returns with full knowledge of all pertinent facts.”

This statement to be accurate should read:

“The evidence discloses that the Bureau of Internal Revenue was informed as to all pertinent facts in connection with its consideration of the

tax settlement and there is no evidence that the Bureau was in any way deceived or misled."

(See as to the negotiations with the Bureau, R. 1308-09, 1312-19, and Exhibits In. 14, P. 64, P. 71.)

III.

Defendants object to plaintiff's proposed conclusion of law on the grounds that it is entirely inconsistent with the decision of the Court and inconsistent alike with the Court's pre-trial order and the stipulation entered into by plaintiff and defendants, and upon the further grounds stated in defendants' objections to the interveners' motion for reargument and to amend findings of fact and conclusions of law.

Dated: November 18, 1949.

Respectfully submitted,

/s/ ALLAN P. MATTHEW,

JAMES D. ADAMS,

ROBERT L. LIPMAN,

BURNHAM ENERSEN,

Attorneys for Defendants, The Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway Company, Delta Finance Co., Ltd., and Standard Realty and Development Company.

McCUTCHEN, THOMAS,
MATTHEW, GRIFFITHS
& GREENE,
Of Counsel.

/s/ EVERETT A. MATTHEWS,
PILLSBURY, MADISON &
SUTRO,
MILBANK, TWEED, HOPE &
HADLEY,

Attorneys for Defendant, The Western Realty
Company.

Receipt of copy attached.

[Endorsed]: Filed November 18, 1949.

[Title of District Court and Cause.]

ORDER UNDER RULE 25(c) DIRECTING
THE JOINDER OF PARTY PLAINTIFF

Upon motion of the plaintiff and of Alexis I. duP. Bayard as Receiver of plaintiff The Western Pacific Railroad Corporation, and it appearing that on October 19, 1949, by order of the Court of Chancery of the State of Delaware, in and for New Castle County, said Alexis I. duP. Bayard was appointed and now is the Receiver of plaintiff corporation to take charge of its estate and effects and to collect the debts and properties due and belong-

ing to it with power to enter his appearance in, and to prosecute and defend in the name of said corporation or otherwise, all suits and proceedings which may be necessary or proper for the purpose aforesaid, including the present action; and good cause appearing therefor,

It Is Hereby Directed that said Alexis I. duP. Bayard as Receiver of The Western Pacific Railroad Corporation be joined, and he is hereby deemed to be joined, as party plaintiff herein, and shall be so denominated in all papers hereafter filed herein.

Dated: November 28th, 1949.

/s/ LOUIS E. GOODMAN,
District Judge.

Receipt of Copy Attached.

[Endorsed]: Filed November 28, 1949.

[Title of District Court and Cause.]

FINDINGS OF FACT AND
CONCLUSIONS OF LAW

Findings of Fact

Plaintiff having proposed findings of fact in addition to the findings contained in the Court's opinion filed herein on September 6, 1949, and the defendant having objected thereto, and the Court being now satisfied that all facts necessary for decision are found in the opinion of September 6, 1949, now adopts by reference all such findings as its formal findings of fact in this cause, for all purposes as if the same were fully set forth herein.

Conclusions of Law

The Court concludes that the plaintiff shall take nothing herein and that the defendants shall have judgment in their favor for their costs of suit.

Dated: November 28, 1949.

/s/ LOUIS E. GOODMAN,
United States District Judge.

[Endorsed]: Filed November 29, 1949.

In the District Court of the United States for
the Northern District of California, Southern
Division

No. 26508-G

THE WESTERN PACIFIC RAILROAD COR-
PORATION, and ALEXIS I. duP. BAYARD,
Receiver,

Plaintiffs,

and

MEREDITH H. METZGER, HENRY OFFER-
MAN and J. S. FARLEE & CO., INC., a
Corporation,

Intervenors,

vs.

THE WESTERN PACIFIC RAILROAD COM-
PANY, et al.,

Defendants.

JUDGMENT

The above-entitled cause having been tried before the undersigned Judge of the above-entitled Court, without a jury, the parties appearing throughout the trial by their respective counsel, and the cause having been submitted to the Court for decision,

It is by the Court ordered, adjudged and decreed that the plaintiffs, The Western Pacific Railroad Corporation and Alexis I. duP. Bayard, Receiver, be denied all relief, and that the intervenors be denied all relief, and that the plaintiffs recover

nothing and the interveners recover nothing from the defendants or any of them.

Defendants are allowed costs against the said plaintiffs and interveners, as follows:

Defendant Western Realty Co. in the sum of \$2936.76.

Defendants The Western Pacific Railroad Company, et al., (other than Western Realty Co.) in the sum of \$3300.60.

The Clerk is directed to enter this judgment forthwith.

Dated: Nov. 30, 1949.

/s/ LOUIS E. GOODMAN,
Judge.

Entered in Civil Docket Dec. 1, 1949.

The within draft of judgment prepared by counsel for defendants, The Western Pacific Railroad Company, et al.

/s/ ALLAN P. MATTHEW,

/s/ JAMES D. ADAMS,

/s/ ROBERT L. LIPMAN,

/s/ BURNHAM ENERSEN,

Attorneys for Defendants The Western Pacific
Railroad Company, et al.

Approved as to form, as provided in Rule 5(d).

· /s/ MAURICE E. HARRISON,
 /s/ HERMAN PHLEGER,
 BROBECK, PHLEGER &
 HARRISON,

Attorneys for Plaintiffs The Western Pacific Railroad Corporation and Alexis I. duP. Bayard, as Receiver.

Approved as to form, as provided in Rule 5(d).

 ROGERS and CLARK,
 /s/ WEBSTER V. CLARK,
 Attorneys for Interveners.

Approved as to form, as provided in Rule 5(d).

 /s/ EVERETT A. MATHEWS,
 PILLSBURY, MADISON &
 SUTRO,
 MILBANK, TWEED, HOPE &
 HADLEY,

 Attorneys for defendant
 Western Realty Co.

[Endorsed]: Filed Novemer 30, 1949.

[Title of District Court and Cause.]

ORDER GRANTING MOTION
TO AMEND JUDGMENT

Judgment was heretofore entered in this cause in favor of defendants and for their costs of suit. Thereafter defendants filed cost bills totalling \$25,907.76. The Clerk then proceeded to and did tax the costs at a total of \$6,237.36.

Plaintiff and interveners have filed and argued two motions: (1) To amend the judgment by striking out the award of costs to defendants and instead ordering each side to bear its own costs and (2) To modify the Clerk's order of taxation by disallowing all items allowed by him except those totalling a nominal amount.

The items now sought to be stricken consist of (a) cost of original daily transcript of trial testimony; (b) cost of copies of daily transcript; (c) cost of original depositions.

There is substantial doubt as to the propriety of the questioned cost items. Furthermore, after hearing the arguments and studying the memoranda submitted, I am of the opinion that I should not have awarded costs to defendants. It appears to me that, under all of the circumstances of this litigation, it would be more just if each side were to bear its own costs.

Consequently, the judgment may be amended accordingly. It is therefore unnecessary to decide the motion to review the Clerk's taxation order.

Prepare order accordingly.

Dated: January 11, 1950.

/s/ LOUIS E. GOODMAN,
United States District Judge.

[Endorsed]: Filed January 11, 1950.

In the United States District Court, for the North-
ern District of California, Southern Division.

No. 26508

THE WESTERN PACIFIC RAILROAD COR-
PORATION and ALEXIS I. duP. BAYARD,
Receiver,

Plaintiffs,

and

MEREDITH H. METZGER, et al.,

Interveners,

vs.

THE WESTERN PACIFIC RAILROAD COM-
PANY, et al.,

Defendants.

AMENDED JUDGMENT

Judgment having heretofore been rendered on No-
vember 30, 1949, and plaintiffs and interveners hav-
ing on December 9, 1949, moved to amend the

judgment, and said motion having been granted, the judgment is amended to read as follows:

It Is by the Court Ordered, Adjudged and Decreed that the plaintiffs, The Western Pacific Railroad Corporation and Alexis I. duP. Bayard, Receiver, be denied all relief, and that the interveners be denied all relief, and that plaintiffs recover nothing and the interveners recover nothing from the defendants or any of them.

It Is Further Ordered, Adjudged and Decreed that defendants do not recover costs against plaintiffs or interveners or any of them, and that each party shall bear its, his or her own costs.

The clerk is directed to enter this judgment forthwith.

Dated: January 13, 1950.

/s/ LOUIS GOODMAN,
District Judge.

The within draft of amended judgment prepared by counsel for plaintiffs.

/s/ HERMAN PHLEGER,
/s/ MOSES LASKY,

BROBECK, PHLEGER &
HARRISON,

Attorneys for plaintiffs, The Western Pacific Railroad Corporation and Alexis I. duP. Bayard, as Receiver.

[Endorsed]: Filed January 13, 1950.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given this 8th day of February, 1950, that the Western Pacific Railroad Corporation and Alexis I. duP. Bayard, Receiver, plaintiffs above named, hereby appeal to the United States Court of Appeals for the Ninth Circuit from the final judgment rendered in this action as amended by Amended Judgment entered herein on January 13, 1950, pursuant to order of January 11, 1950, in favor of defendants and against plaintiffs.

/s/ HERMAN PHLEGER,

/s/ MAURICE E. HARRISON,

/s/ MOSES LASKY,

BROBECK, PHLEGER &
HARRISON.

/s/ FRANK C. NICODEMUS, JR.,

/s/ A. PERRY OSBORN,

/s/ MAHLON DICKERSON,

/s/ NORRIS DARRELL,

/s/ LEROY R. GOODRICH,

Attorneys for Plaintiffs and Appellants, The Western Pacific Railroad Corporation and Alexis I. duP. Bayard, Receiver.

[Endorsed]: Filed February 8, 1950.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that Meredith H. Metzger, Henry Offerman and J. S. Farlee & Co., Inc., plaintiffs in intervention above named, hereby appeal to the United States Court of Appeals for the Ninth Circuit from the final judgment rendered in this action as amended by Amended Judgment entered herein on January 13, 1950, pursuant to order of January 11, 1950, in favor of defendants and against plaintiffs and plaintiffs in intervention.

Dated: February 8, 1950.

/s/ WEBSTER V. CLARK,

ROGERS and CLARK,

/s/ DAVID FREIDENRICH,

/s/ JULIUS LEVY,

Attorneys for Plaintiffs in Intervention and Appellants Meredith H. Metzger, Henry Offerman and J. S. Farlee & Co., Inc., a Corporation.

[Endorsed]: Filed February 8, 1950.

[Title of District Court and Cause.]

DESIGNATION BY APPELLEES OF ADDITIONAL PORTIONS OF THE RECORD, PROCEEDINGS AND EVIDENCE TO BE CONTAINED IN THE RECORD ON APPEAL

Appellees, The Western Pacific Railroad Company, and The Western Realty Company, defendants in the above-entitled action, designate the following additional portions of the record, proceedings and evidence to be contained in the record on appeal in the above-entitled action:

1. Reporter's transcript of hearing on motion of interveners to intervene, April 7, 1947.
2. Reporter's transcript of Pretrial Conference, January 11, 1949.
3. Reporter's transcript of oral argument at conclusion of trial, February 23, 1949.
4. Defendants' Objections to Findings and Conclusions Proposed by Plaintiff dated November 18, 1949, and filed same date.
5. All entries made by the District Court Clerk in the Civil Docket of the U. S. District Court, Northern District of California, Southern Division, pertaining to the above-entitled action.

6. This designation.

Dated: February 16, 1950.

/s/ ALLAN P. MATTHEW,

/s/ JAMES D. ADAMS,

/s/ ROBERT L. LIPMAN,

/s/ BURNHAM ENERSEN,

/s/ WALKER LOWRY,

Attorneys for Defendant, The Western Pacific Railroad Company, et al.

/s/ EUGENE M. PRINCE,

/s/ EVERETT A. MATHEWS,

PILLSBURY, MADISON &
SUTRO,

Attorneys for Defendant,
The Western Realty Co.

Receipt of copy attached.

[Endorsed]: Filed February 16, 1950.

[Title of District Court and Cause.]

CIVIL DOCKET

1949

Sept. 6—Order Judgment for Defendants as will appear more fully in opinion this day filed.

Nov. 30—109. Filed Judgment that plaintiffs and interveners recover nothing and defendants to recover their costs as determined. Entered Dec. 1, 1949.

Jan. 11—Order judgment may be amended and each side to bear own costs, per order signed this date. (Goodman)

In the Southern Division of the United States District Court in and for the Northern District of California

Before: Hon. Louis E. Goodman,
Judge.

No. 26,508-G

THE WESTERN PACIFIC RAILROAD CORPORATION,

Plaintiff,

vs.

THE WESTERN PACIFIC COMPANY, et al.,
Defendants.

Before: Hon. Louis E. Goodman,
Judge.

REPORTER'S TRANSCRIPT

Monday, April 7, 1947

Appearances:

For the Plaintiff:

LEROY R. GOODRICH, ESQ.

For the Defendants:

WEBSTER V. CLARK, ESQ.,

JAMES D. ADAMS, ESQ.,

ALLAN P. MATTHEW, ESQ.,

EVERETT A. MATHEWS, ESQ.

* * *

The Court: In other words, these corporations having been advised that the law permits, or saves

them some money in taxes, now want the Court to decide how the saving shall be divided.

Mr. Clark: Precisely. And without the benefit of any other facts, the matter is passed up to the Court to decide who is entitled to this refund.

Frankly, in that view of the case, on the basis of the allegations in the complaint, it is our opinion that the Court could do nothing but to award the moneys to the operating company in accordance with certain defenses which are set forth in its answer, and in view of the fact that the moneys for which refund is claimed were paid by the operating company and the tax saving was with respect, only in large part, to moneys which it had earned. I say on the basis of this complaint as it is filed in the court, your Honor, the Court, could do nothing but to decide the matter, it seems to us, in favor of the operating company.

* * *

The Court: The applicants for intervention are stockholders of which company?

Mr. Clark: Holding company, the company whose tax loss was used. What could have been done and what the directors should have done, may it please the Court, is to have forced an apportionment by agreement of the tax loss from the subsidiary companies before permitting the use of the loss belonging to holding without any benefit to its stockholders.

* * *

The Court: The plaintiff in the case is asserting

that it is entitled to the benefit of this tax situation?

Mr. Clark: Yes, but it does not allege facts necessary in this complaint to entitle it to a recovery, in our opinion.

* * *

The Court: Mr. Clark, how could it make any difference ultimately as a matter of law with respect to the allocation of this tax refund as to whether or not the James interests had the control in both companies? The Court can't decide how the money should be allocated.

Mr. Clark: I think so, your Honor.

The Court: How could that be?

Mr. Clark: Because if we are going to get into a discussion of the merits, all the declaratory relief complaint says is that these companies were consolidated companies during the years in question, or affiliated corporations within the meaning of Section 141, and that is conceded, because if there is any recovery at all, it must have been. Then, the declaratory relief complaint says there is no statute or regulation apportioning benefits or tax benefits or liabilities among members of an affiliated group. Therefore, we place it in the lap of a court of equity to decide who is entitled to the recovery.

On that state of the matter, may it please your Honor, it must be perfectly obvious, and I think the gentlemen who filed this complaint, it must have occurred to them, so far as the Court is concerned, a fair apportionment of the benefits would be to the

fellow who pays the tax, and that is the position of the railroad company, represented by Mr. Mathews and Mr. Adams.

* * *

[Endorsed]: Filed Nov. 9, 1948.

In the Southern Division of the United States
District Court for the Northern District of
California

No. 26508-G

THE WESTERN PACIFIC RAILROAD COR-
PORATION,

Plaintiff,

and

RUSSELL M. VAN KIRK, HENRY OFFER-
MAN and J. S. FARLEE & CO., INC., a Cor-
poration,

Intervenors,

vs.

THE WESTERN PACIFIC RAILROAD COM-
PANY, et al.,

Defendants.

PROCEEDINGS ON APPLICATION FOR
TEMPORARY RESTRAINING ORDER

Before: Hon. Louis E. Goodman,
Judge.

REPORTER'S TRANSCRIPT

Monday, August 25, 1947

Counsel Appearing:

LEROY R. GOODRICH, ESQ.,

For the Plaintiff;

ROGERS & CLARK, by

WEBSTER V. CLARK, ESQ.,

DAVID FRIEDENRICH, ESQ., and

POMERANTZ, LEVY, SCHREIBER, by

JULIUS LEVY, ESQ.,

Attorneys for Interveners Russell M. Van
Kirk, Henry Offerman and J. S. Farlee
& Co., Inc.

ALLAN P. MATTHEW, ESQ., and

JAMES D. ADAMS, ESQ.,

For the Defendants.

Mr. Clark: May it please your Honor, this matter involves the presentation to your Honor of a temporary restraining order and order to show cause on the part of the interveners Van Kirk, etc. The occasion which in our opinion, may it please the court, necessitates such action is a proposed settlement between the defendants in intervention and the United States Government, concerning the tax saving and refund claim which, your Honor may

remember, constitutes the subject matter of this action.

May I just briefly review the facts, because this matter was before the court only upon our application to intervene some months ago: The interveners are preferred stockholders of the holding company called Western Pacific Railroad Corporation, which at one time owned all of the stock of one of the defendants in intervention, Western Pacific Railroad Company. As your Honor will remember, the company was in reorganization in this court from approximately 1935, I think it was, until the last of 1943, and in that reorganization the stock of the operating company, the corporation in reorganization, was declared valueless by the United States Supreme Court, confirming the plan of reorganization confirmed by this court. Thereafter, in 1944 the directors of the holding company, we assert, by virtue of domination and control over them by certain interests, caused a consolidated income tax and excess profits tax return to be filed on behalf of itself, the holding company, and all of these defendants as affiliated companies within the meaning of that section of the Internal Revenue Code, and in that return there were set up as a loss on the part of the family of companies the loss of the value of the stock held by the holding company in the operating company, which loss was the result of the reorganization. That loss resulted in a tax saving for the years 1943 and 1944 to the operating company of \$10,100,000, and, in 1942, a claim for refund in the amount of \$4,200,000.

There was a suit brought in New York by Mr. Levy's firm—and he is here and will present this to your Honor—in which an apportionment of that tax saving on that refund claim was sought to be recovered for the holding company. It had given up its tax loss, received nothing for it, and the use of that loss resulted in that \$14,000,000 saving to the operating company out here, and various subsidiaries. The New York action was pending in the Southern District for New York. Motions to dismiss had been overruled when the corporation appeared in this jurisdiction and filed the action which we roughly called an action for declaratory relief during the time we discussed the application to intervene, and in that action the corporation, which company we contend is dominated by the operating company and various other interests, simply stated to the court in the complaint in the declaratory relief action that this loss had been so used that the saving had resulted and it wanted the court, in the exercise of its equitable powers, to declare what apportionment there should be, inasmuch as there was no statute or rule of law which covered the matter, and in that declaratory relief complaint, if it can be properly called such, there was no allegation concerning the domination which had caused the misuse, we contend, of this tax loss to the detriment of the stockholders of the holding company. Therefore, Mr. Levy's firm associated Mr. Friendenrich and myself to prepare a petition for intervention in the declaratory relief action,

which we did, and in that we allege what we think are the controlling facts in the case, and that is the matter your Honor heard, and you granted us the right to intervene, and we filed a complaint in intervention.

Now, so far as the California action is concerned, may it please the court, two of the defendants in intervention, that is, the corporation, being the company on behalf of whom our people seek to intervene as minority stockholders, and another subsidiary called Western Realty Company, represented by Pillsbury, Madison & Sutro, have filed answers. The operating company, represented by Mr. Matthew and Mr. Adams, and their firm, have filed a motion to strike, which is now set on your Honor's calendar for September 15th, and we may possibly ask you to continue that further, pursuant to stipulation of counsel. But meanwhile, all these parties, except the plaintiffs in intervention whom we represent, it seems, have or are about to consummate a settlement with the Government on or pertaining to this very tax-saving refund claim which constitutes the res of the subject-matter of the action, and (Mr. Levy is familiar with this and will describe it to your Honor) the settlement is of such a nature that it will stultify us and place a part of this fund possibly beyond the reach of interveners or the corporation in the event it is consummated, and this restraining order, which we intend to present to your Honor, has for its purpose to restrain these parties from consummating

that settlement, and particularly from giving the Government a release on the refund claim of \$4,200-000, which to our mind is a portion, at least, of the res to which certain technical defenses in the suit before your Honor do not apply.

May it please your Honor, I would like to present to your Honor Mr. Julius Levy, of New York, whose firm appears of counsel on the pleadings, and I would like to move the court to admit Mr. Levy in this district for the purpose of this particular litigation.

The Court: Very well, Mr. Levy may be admitted.

Mr. Levy: Thank you, your Honor, for this privilege. I have come a long way from New York, and we have done it only because we consider this particular aspect of the case of great importance, as great in importance as the necessity for our intervention in the corporate action. In fact, it is our opinion, and perhaps your Honor's when you have heard all the facts, that what has been done here is a further step in the course of conduct between these corporations which has evidenced the domination and control of the conflicting interests, at the expense of the corporation for the benefit of the company.

We were aware of the facts which were pleaded in the complaint going to the question of domination and control, and your Honor may recall that one of the strong elements in that chain of factual circumstances has been that throughout the years, when the consolidated tax returns were being filed,

the corporation and the company were represented by one tax counsel of the firm of Whitman, Ransom, Coulson & Goetz, of New York, and for a large period of that time the corporation and the company had one firm of general counsel representing both companies, and since the reorganization has concluded the corporation's president has, by retainer or contract, via Whitman, Ransom, Coulson & Goetz, been working for the railroad company, and another one of the corporation's officers, the secretary, is employed in the firm of Whitman, Ransom, Coulson & Goetz, and in addition to that Mr. Coulson is the trustee of a foundation which owns 40 per cent of the stock of our corporation, but unfortunately most of which is common stock and is so far under water as to be worthless, and at the same time 20 per cent of the railroad company, which, as your Honor may well take judicial notice of, is a fine, going, substantial concern, and it has been the duality of allegiance, as we see it, that resided in tax counsel which supposedly were able to disassociate themselves from their entanglements as to be able to press our claims and at the same time press the railroad company's claims.

One further factor I would like to advert to as background is this: In this very action one of the answers submitted on behalf of Western Realty Company, one of the defendants, is signed by Whitman, Ransom, Coulson & Goetz as their attorney, and it openly and frankly states that the corporation is entitled to no part of these tax savings. With that in mind, and having the feeling that this tax

matter with the United States Government, must sooner or later reach the stage where the parties are sitting across the table and talking about it, we dispatched a letter to Whitman, Ransom, Coulson & Goetz and the corporation and we stated in that letter that because of these background circumstances we felt that the corporation did not have that independent aggressive representation to which it was entitled in the course of those negotiations and, therefore, we suggested that we be permitted to participate in those negotiations, and that at least we be advised at what stage they had reached and what has been going on.

Well, we did get answers to that, and the answers were ultimately a flat rejection of our request, but it produced this much: We were invited to a conference with Mr. Polk, of Whitman, Ransom, Coulson & Goetz' firm, who, by the way, reiterated that his job was that of the tax work, and please don't ask him about what the other end of his firm was doing in connection with the internal quarrel here. We had that conference with Mr. Polk, and we were there advised that a settlement offer had been made by Mr. Polk to the United States Government, and that settlement offer was this: You, the United States Government, sustain the tax returns for 1943 and 1944 under which we, the railroad company, save ten million dollars, approximately, in taxes which we did not pay; at the same time reject the tax refund claim which is made by the corporation.

Now, if you were to view the settlement as being a settlement for ten million dollars of a fourteen million dollar tax claim and that were all there were to it——

The Court: The claim for refund was made by the corporation?

Mr. Levy: The claim for refund was made by the corporation as the parent company, and in the normal course of events, had that claim been allowed, the check would have come to the corporation. I will embellish that a little further as I go along. But at the outset, to make our position clear, I would like to say had this involved nothing more than the question of a ten million dollar settlement of an overall claim of fourteen million dollars, we would probably say, "Well, by gosh, if you can get ten million dollars out of a fourteen million dollar claim, O.K., let's take it and forget the balance. At least that is money in the bank rather than litigation."

That is not what this settlement involves. Our objection is that the form in which it is couched gives to the railroad company an advantage in this litigation which may prove the death knell to the corporation's claim on the merits, and I will try to demonstrate to your Honor how that comes about, how we see it: To begin with, the validity of the tax returns and the tax refund claim are all premised on the same question——

The Court: Is this matter contested? Or are you going to make some order by consent?

Mr. Clark: If it please your Honor, I was down

in Fresno trying a case when Mr. Levy got in touch with me last Friday. I immediately phoned your Honor's secretary to make an appointment to present to your Honor a restraining order and an order to show cause, restraining the consummation of this settlement until it could be heard on its merits, and a preliminary injunction passed upon; and the appointment I got with your Honor was at four o'clock this afternoon. Now, so that we would not be in the position of coming out here and asking your Honor to sign a temporary restraining order and an order to show cause without notice, I telephoned to Mr. Adams and to Mr. Goodrich and to Mr. Matthew and told them we were coming here, so that they would know what was being done, and be able to voice any objection. The thing we are presenting to your Honor is simply a restraining order and an order to show cause, returnable just as soon as your Honor can order it. I put the date next Friday in——

The Court: Does the other side object to the issuance of a temporary restraining order?

Mr. Adams: Yes, your Honor, we do.

The Court: That is all I wanted to find out. If we are going to argue this matter—I had no idea that this was to be a hearing on an application for a preliminary restraining order. My secretary told me it was some matter that could be presented in chambers, as I got it.

Mr. Clark: That is precisely what I suggested to her, that we simply present the restraining order

to your Honor, explain the matter to you, and have the arguments set.

The Court: If the other side is going to object to my issuing a temporary restraining order to stop them from settling a claim that involves ten million dollars, I do not see why you would want to hear it at four o'clock in the afternoon.

Mr. Clark: It is only the urgency of the matter, your Honor, because we understand the settlement is imminent.

The Court: I could have set it earlier this afternoon.

Mr. Clark: Four o'clock in the afternoon was the earliest date I could get from your secretary.

The Court: I had some other matters on, but I thought counsel wanted to come and talk with me about some order in chambers, and so I said, "Come out at four o'clock." I would be reasonably sure of being through with my calendar.

Mr. Levy: I think I can have this presentation over in five minutes.

Mr. Adams: May I say, your Honor, we have not seen the form of order or any papers, but have appeared in response to the courtesy of counsel in designating this time and place, and we should, of course, like to be heard in opposition to the motion, but we would like to see the motion. We have not seen any papers yet.

The Court: I understand counsel are applying to the court for a temporary restraining order, with an order to show cause fixing a date at which the motion for a preliminary injunction may be argued.

Mr. Clark: Precisely, your Honor.

The Court: Instead of applying to the court *ex parte* for that restraining order they have notified you. Of course, I do not know whether it would even be proper to apply for a temporary restraining order in an action that is pending unless counsel appeared without notice. That is beside the point. You are here now. You wish to oppose the issuance of the temporary restraining order?

Mr. Adams: Yes, your Honor, we do.

The Court: That means you are going to argue the question as to whether the temporary restraining order should issue.

Mr. Adams: We should like to present argument.

The Court: We will go as far as we can until about five o'clock. If we can't finish it we will go over. I have a criminal case starting tomorrow morning.

Mr. Clark: If we could get some expression from these gentlemen, your Honor, as to the imminency of this settlement perhaps we can get together on a time when the whole thing could be properly argued and the application for preliminary injunction passed upon. But as far as I was concerned, I was in Fresno trying a case. Mr. Levy was advised of these facts in New York, flew out here, and we are approaching your Honor at the earliest appointment I could get from your secretary with a restraining order and an order to show cause, bringing up the entire question. Our only purpose is to stop this settlement.

The Court: You want to stop the settlement from being consummated?

Mr. Clark: Until your Honor passes upon our right to preliminary injunction, precisely, because we feel it prejudices us to the extent of some four million odd dollars in the litigation which is before your Honor.

The Court: You mean you are not satisfied with the settlement they are making?

Mr. Clark: Mr. Levy was making that point.

Mr. Levy: I was just about to get to that, your Honor.

The Court: I asked Mr. Levy if it was a corporation's claim for refund that was pending.

Mr. Clark: That is right.

The Court: You are intervening on behalf of the stockholders of the corporation?

Mr. Levy: Correct.

The Court: So it is your own claim for refund, that is, it is the corporation's claim for refund that is now being settled?

Mr. Levy: It is not just that simple your Honor. The overall picture here is that there was a tax saving for ten million dollars for two years. That is an inchoate thing. It was simply a saving of taxes which otherwise would have been assessable against the railroad company out here, but they were never paid, and it was the use of the corporation's loss that I adverted to. In addition to that, if your Honor please, there is a fund, or will be a fund, or would have been a fund represented by a claim for refund for another year for \$4,200,-

000. The justification for both the saving and the claim for refund is the same.

The Court: Then what you are objecting to is the settlement of the claim on an improper basis as to amount?

Mr. Levy: May I go on with that, your Honor? I was just coming to that, and that is the heart of this application.

The Court: The only reason I interrupted was, I was trying to find out the nature of this proceeding.

Mr. Levy: Perhaps I was somewhat long-winded in giving you the background. Here is the precise question we are urging to you at this time: We say this proposed settlement will give to the railroad company a "clean bill of health" on their ten million dollar savings which have accrued for the years 1943 and 1944. At the same time, the Government will reject the four million dollar claim for refund. Now, our objection is this——

The Court: Ten million is the claim for refund——

Mr. Levy: No, the ten million is saved by reducing the taxes that would have been paid from ten million to zero, by reason of off-setting these losses.

The Court: I see now what you are getting at.

Mr. Levy: Let us see what the effect of this settlement is. The effect of this settlement is the railroad company, which had ten million, still retains possession of that ten million dollars. On the other hand the corporation, which had a claim

for refund, which had it been paid would have been paid to it by the United States Government, was to receive nothing under this settlement, so that the entire res, after this settlement is consummated, if it should be, will be in the possession of the railroad company; none of it will be in the possession of the corporation.

Now, why is that of any significance? It is significant in this case——

The Court: The corporation claims an interest in that ten million as well as in the four million?

Mr. Levy: Yes, by the litigation, but it has no physical possession of it. And why is that important to this litigation? The railroad company, in response to the corporation's action to recover an interest in that ten million dollars worth of savings that the railroad company has, the railroad company, in its answer, has set up certain defenses. It has said, 1, you are barred from suing us as a result of a bankruptcy order; 2, you are barred from suing us because your statute of limitations has run; and, 3, you are barred from suing us because laches has prevailed. Therefore, if we have to sue the railroad company in order to assert an interest in that ten million dollars, then before we ever get to a decision on the merits, the court may say, "Well, we are very sorry, your equitable claim is a fine one, but you are defeated by three technical defenses, or any one of them." If, however, in addition to the corporation's having ten million dollars worth of savings we had four million dollars worth of refund in our till, then if the railroad

company wished to get that back from us it would have to sue us, and in fact in this very action the railroad company has a counterclaim where they say that this claim for refund is in the name of the corporation; the check would be paid to the corporation, the corporation may run off with it, so we ask that we get judgment against the corporation for the amount of the refund. Now, without possession of that refund money, without possession of the proceeds, the railroad company would never have to sue us and we would then be in a position where our entire action to share in the contested res may well be defeated because of technical defenses going to our right to sue. That is why I say our objection is not to the settling of a fourteen million dollar tax claim for ten million dollars; our objection is to the form in which that settlement is couched. In the normal course, if we had two companies paddling their own canoes, the settlement would take the form as follows: We have a fourteen million dollar claim. We are settling it for ten million. Ten-fourteenths will go to the railroad company and ten fourteenths will go to the corporation, and if you have a fight as to who is entitled to what, take your case to court and let the court determine the matter. That is the position that we say we ought to be in even when there is a settlement. I would like to ask my adversaries here why there could not be this internal shuffling between the parties whereby some part of that ten million dollars, ten-fourteenths of four

million, is paid to the corporation, and ten-fourteenths of the ten million is paid to the company. Why can't that be arranged as the method of settling instead of leaving the entire res with the railroad company and leaving the corporation with nothing? And then to add insult to that, to have the railroad come in in our lawsuit and say, "You fellows are barred from suing us. Now that you have the ten million and we have nothing, you can't sue us." That is why we say we need a temporary restraining order and a permanent injunction here. We say that this court should restrain these parties from so settling this case unless they are willing to reshuffle the amount of the settlement so as to leave with the corporation its proportionate share of this refund claim and leave the company its proportionate share of the tax savings.

The Court: Suppose this is the way the Government wants to make this settlement?

Mr. Levy: If that is the way the Government wants to make the settlement, there is nothing to prevent the parties from doing what the right thing requires them to do.

The Court: Then if that is the case, why do you need a restraining order? Does not a court of equity have the inherent power to look into the transaction, irrespective of the form of settlement and say that they would not have the right to make these technical defenses?

Mr. Levy: When you have a lawsuit that is full of hazards, you hate to add another one. We have

the hazard of whether a court of equity has the right to ignore the statute of limitations or the bar of the bankruptcy order.

The Court: What I mean to say is, can't a court of equity say while a settlement was made in this form, that in reality it was a settlement of 10/14ths of the whole claim, and therefore, that being the case, the railroad corporation is in the same position in a court of equity as it would be had it part of these funds in its possession? If that is the true fact of the matter, if that is the truth of the matter, why would equity be hamstrung by some such technical situation as you suggested might be availed of?

Mr. Levy: I think it would in this respect: Your Honor has to decide a lawsuit. We have a claim against the defendant. The defendant says, "You have no right to sue. You have no right to inquire into the merits." And if we have no right to sue, then we do not have the opportunity to bring into play these equitable doctrines, because we are barred from asserting the claim in this court, and since they have possession of the res, then there is no way by which we can urge them other than by a lawsuit.

The Court: Who represents the corporation in this litigation?

Mr. Levy: Mr. Goodrich.

The Court: Mr. Goodrich represents the corporation and Mr. Matthew represents the company.

Mr. Matthew: And Mr. Adams.

Mr. Adams: Mr. Matthew represents the Western Realty Company.

The Court: Pillsbury, Madison & Sutro represent the railroad company, and you three gentlemen represent the interveners. Is there any objection on the part of the corporation and the company agreeing now, despite the form of the settlement, that they will treat it as if it were a 10/14ths settlement of the whole?

Mr. Adams: May I respond to that, your Honor? I think the statement of counsel, so far as it goes, might have been supplemented with reference to a stipulation, the precise text of which would be of great interest to your Honor, and it should be read. The stipulation (and I say this subject to correction in precise detail) as to its terms provides that as between the parties to the litigation—and this is made between the corporation, on the one hand, and the Western Realty on the other hand, and our clients on the third hand—it provides that this settlement with the Government shall be without prejudice to the respective claims and defenses of the parties to the litigation, except that all those claims and defenses shall now be deemed to relate to a tax saving as reduced by the settlement with the Government. It provides specifically and more particularly that the claim for refund shall be deemed to have been allowed in the proportion which it bears to the net reduced amount tax saving, and that the tax saving for the subsequent years shall be deemed to have been reduced in like proportion. It further provides, and in particular,

that the defenses shall not be imperiled, waived, or prejudiced, nor shall the claims be imperiled, waived, or prejudiced except and all thereof now relate to a fixed amount of tax saving or a determinable amount, in consequence with the settlement with the Government. I think your Honor will find that the stipulation, to put it in more brief terms, reads substantially to the text which your Honor has announced from the bench.

The Court: That stipulation has been entered into?

Mr. Adams: That stipulation has been agreed to between counsel for the corporation, Mr. Nicodemus, Mr. Goodrich, and counsel, that is, ourselves, for the company, and I understand counsel for the Western Realty Company will enter into the stipulation. I think, however, that it should be said that that stipulation was prepared and presented to the Board of Directors of the corporation by ourselves, representing the company, that is, through Mr. Goodrich, and that the Board of Directors of the corporation had before it our agreement to make the stipulation before the board approved the corporation continuing with the settlement with the Government. As Mr. Levy has stated, there is no argument between any party to this litigation about the desirability of determining the tax liability with the Government in an amount of about 10/14ths or 5/7ths of the possible total saving, and this stipulation was entered into at the instance of counsel for the corporation, who came to us shortly

ago and stated that they thought that the settlement with the Government, without an agreement of that sort, might prejudice their position. We, on our part, thought that an agreement that the settlement should prejudice neither the one party nor the other, would be an appropriate stipulation to make, and we resisted at all times, and will continue to resist, any effort to obtain or extract an advantage for another party as against our client, but we feel that this stipulation does not have that effect, either as to us or as to the corporation. I have answered your Honor somewhat fully.

The Court: Would the language of that stipulation cover the point that Mr. Levy makes that the corporation would be in the same position as if it had, as a result of the settlement, a part of these funds in its possession in respect to any defenses that might be urged?

Mr. Adams: I might at this time hand up to the court a copy of the stipulation and then read from it, if I may.

The Court: Mr. Levy, do you think that stipulation does not cover the matter?

Mr. Levy: Yes, sir, I think it does not.

Mr. Adams: You saw the stipulation?

Mr. Levy: I saw it.

The Court: That is really the crux of the matter.

Mr. Goodrich: That is the crux of it.

Mr. Levy: May I ask a question? I would like to ask both of my adversaries this hypothetical question: If the judgment of this court after the settlement is consummated should be that we are

barred from suing because of laches, or limitations, or the injunction order, will we get physical possession in our till of ten-fourteenths of \$14,200,000, or will the railroad company retain that?

Mr. Adams: Do you wish an answer, Counsel?

Mr. Levy: I do.

Mr. Adams: I will attempt to respond to the question asked, your Honor, by stating that in our view the corporation has not the slightest claim, right, or interest in any of this tax saving. We think it all belongs to the company.

Mr. Levy: Mr. Goodrich, whom do you represent?

Mr. Adams: I am speaking for the railroad company, and my name is Adams.

Mr. Levy: I am sorry.

Mr. Adams: We anticipate such may be the judgment of the court, which is the judgment we shall urge the court to give. We contend that each of the defenses which we make on the score of the bar, laches, and limitations are sound and are not technical, and we contend also that upon the merits and in equity there is no claim before this court to any part of this tax-saving which has the slightest justification, other than the right of our company, the taxpayer. That will be and will continue to be our position, and it has been made clear also to the directors of the corporation, and counsel for the interveners is aware of it. We contend that the corporation is in duty bound and is fiduciary in respect to the matter of obtaining this settlement with the Government.

The Court: Why was the settlement with the Government made on the basis of the ten-million-dollar claim allowed and the four million dollars rejected? Is there some special reason for that? Mr. Levy seems to think astute counsel for the parties arranged that so that they might anticipate this claim that he is now making.

Mr. Adams: I would like to make a complete disclaimer as to that, and I think the stipulation will satisfy your Honor that no such thought was in the minds of the parties. The tax settlement was made by Mr. James K. Polk, who is an eminent specialist in the tax field, and who has handled tax matters. That is a matter which has not been before your Honor. That is something to do between the taxpayer and the Government. The reasons why the settlement took this form are undoubtedly technical reasons having no relation whatever to the issues involved in this controversy, and as counsel put it, in equity (and as I think the stipulation puts it to the same effect) the settlement in the form in which it is made is not to have the effect assigned by counsel of an exaction on the part of our client as against the corporation, another party; nevertheless, we do contend and will continue to contend that the corporation has not the least vestige of any meritorious claim to any part of this money, and I would like your Honor to feel clear that that is so. We recognized when Mr. Nicodemus——

Mr. Levy: May I say I do not think the question has been answered.

Mr. Adams: That doubtless was occasioned by the nature of the question, Mr. Levy. I will stop shortly. I just want to say we recognized when Mr. Nicodemus and Mr. Goodrich came to us, as they did some while back, and said they were apprehensive that the form of the settlement with the Government might be prejudicial to their clients, while we claim their clients had no rights, they were counsel in court presenting a claim of right, and so we endeavored in the stipulation to deal with them on the basis that they claimed they had a meritorious right which we denied, and that stipulation, as your Honor will see, I think worked the thing out so that their claims of right are not lost in consequence of the form of settlement, but our defenses to those claims were not lost, either.

The Court: Mr. Goodrich, are you of the same view as the interveners?

Mr. Goodrich: We are of the same view as the interveners to this extent, your Honor, that our claim on behalf of the corporation is put forth in complete good faith, that the corporation is entitled to all the tax saving which results from the losses suffered by the corporation. What happened was that the 1942 consolidated return was filed and taxes paid.

The Court: I remember that part of the presentation of this matter which was made before me some time ago, but what I am specifically inquiring about is this: Are you in accord with the interveners' claim that the form of this settlement, no

matter whether it was activated by the exigencies of the settlement, itself, or by a desire to gain some advantage, do you or not agree that the corporation's rights have to be protected by stipulation or otherwise so that the settlement negotiated by the company will not have the effect of depriving the corporation of some legal rights in connection with the litigation itself?

Mr. Goodrich: When we approached Mr. Matthew's office on this matter we raised the identical points that Mr. Levy has raised, namely, that here was a claim for refund of four million two hundred thousand dollars, which if it was paid by the Federal Government would necessarily be paid to the Western Pacific Railroad Corporation, to our clients. On the other hand, as for 1943 and a portion of 1944, no tax was due if the entire loss sustained by the corporation were allowed by the Federal Government; but to safeguard itself from the possibility of paying taxes, the railroad company set up and now has earmarked in a separate fund \$10,100,000. We suggested to Mr. Matthew's office, Mr. Matthew and Mr. Adams——

Mr. Levy: When was this, Mr. Goodrich?

Mr. Goodrich: This is not dated. Do you recall the exact date, Mr. Matthew?

Mr. Matthew: About three weeks ago.

Mr. Levy: The date of the form of settlement is February 11, 1946, which was submitted to the United States Government; in other words, the corporation had submitted a form of offer to the United

States of America before it had gotten a vestige of consent from the railroad company that any settlement by them would be entered into.

Mr. Goodrich: May I correct that briefly, Mr. Levy? My understanding is that an offer of settlement on behalf of the group of corporations was made to the Government by Mr. Polk, who was acting as tax counsel for the entire group, and had been for sometime previously. As to whether the Government would accept that offer, or not, was still doubtful, but finally the Government officials in the Bureau indicated that they might be willing, if we waived the claim for refund for 1942, to allow all the losses for 1943 and a portion of 1944. It still remained open for the corporation as to each one of the corporations in this group to consent to the waiver of the claim for refund or not, and as late as several days after we were in Mr. Matthew's office working out this stipulation. It was still possible for the corporation to withdraw its power of attorney to Mr. Polk and withdraw its consent to the waiver of claim for refund. We went to the counsel for the railroad company and presented to them the problem, in a sense, that Mr. Levy has raised here, and we told them that we did not feel that we could recommend to the board of directors of the railroad corporation a continuance of their consent to the proposed settlement unless we could work out some program by which the interests of the railroad corporation, as well as the company, and the Western Realty Company, as to all the

balance of the fund would be preserved proportionately, exactly as it would have been if we had refused to go through with the settlement or the refund had actually been made by the Federal Government. It was on that basis that this stipulation was worked out, and I think it is only fair to the court to say that on both sides counsel worked very diligently and earnestly to try to present to this court that matter clearly. All we could do was agree that this stipulation could be made if the claim for refund was rejected by the Government on our consent. We attempted to work out a stipulation that would be clear and simple for this court, and that would preserve in precisely the same status every position, every right, every defense, every possible cause of action that any of the parties might have, but would preserve it in a fund that was lowered proportionately by the waiving of the claim for refund, so that what we have now, subject to all the rights and all of the defenses that we had before, is a claim for a little over \$14,000,000, reduced to a little over \$10,000,000. That is my understanding of the meaning of this stipulation. I am perfectly willing to state that at any time to the court, and I think that Mr. Adams will say it is their understanding of the stipulation from the standpoint of the railroad company.

The Court: Does the stipulation meet the precise question Mr. Levy raises, that is, that it is stipulated that the settlement on this basis would have the same effect upon the rights and obligations of

the parties as if 10/14ths of this money were in the possession of the corporation? That is the point, isn't it?

Mr. Levy: I want to concretize it with this question: If this action should be dismissed on any one of the three technical defenses, who will be left with the physical possession of 10/14ths of the \$4,200,000? I think that can be answered flatly.

Mr. Adams: If this lawsuit is lost, your Honor, by interveners or by the corporation upon any ground, the railroad company will keep the money.

The Court: There is no doubt about that.

Mr. Goodrich: There never was any doubt about it.

Mr. Levy: Oh, your Honor, on any ground. In other words, what Mr. Adams has just said is that if you sustain the defense of laches, limitations, or the injunction order, we will not have possession of 10/14ths of \$4,200,000. Now, had this refund claim been settled as it should have been, so that we would get possession of 10/14ths of \$4,200,00, then if this lawsuit were defeated on any one of those three technical grounds, we would be in possession of the 10/14ths of \$4,200,000, and the railroad company would have to come and sue us without the benefit of a bar of the statute of limitations, without the benefit of a bankruptcy order. They would have to sustain on the merits that they are entitled to the 10/14ths of \$4,200,000, and that is the crux of this discussion, your Honor.

The Court: Do you agree or disagree with that, Mr. Goodrich?

Mr. Goodrich: I do not agree, your Honor, because I think this stipulation means very simply that as to 4/14ths of the remaining \$10,100,000, both the railroad corporation and the railroad company are in precisely the same position that they would have been in if the claim for refund had been allowed. As to the remaining portion of the \$10,100,000, we are likewise in the same position that we would have been in if the claim for refund had been allowed. All that happens is that the aggregate amount is reduced, but proportionately to the balance that is left, which is now \$10,100,000, in proportion to the two different segments of that reduced fund. My view of this stipulation is that it says very plainly that the parties agree that as to each part, the 4/14ths and the 10/14ths, the position of the parties is unchanged.

Mr. Levy: That is not Mr. Adams' position. He has been frank enough to so state.

Mr. Adams: If I may state my position again, just to make sure I do not make a misstatement about it, we consider ourselves bound by the Stipulation, all its statements, and all its intendments. I had understood the question to be that if we were successful in this lawsuit in obtaining a judgment against these parties upon any ground, would we keep the money, and of course the answer to that is we would, and we have it.

Now, I had understood Mr. Levy to have asked a question earlier which I did not answer, and I will try to state the question and, Mr. Levy, see if

I am correct: Your question is, whether this stipulation would result in money coming into the hands of this corporation. Is that your question?

Mr. Levy: That was not my question. May I ask it again, your Honor? It is crucial to the issue here.

The Court: I understand it.

Mr. Levy: Apparently Mr. Adams does not, although I thought I had by his answer. The question is this: Under this stipulation, if the court on the trial should determine that the plaintiff, the corporation, is barred from asserting its claim against the railroad company because of laches, limitations, or an injunction order, who would be left with 10/14ths of \$4,200,000? Will the railroad company retain it in its possession, or will the corporation say, "We have that 10/14ths. Come and sue us if you want it"?

Mr. Adams: I had better try to answer that in this way, your Honor, if I understand it correctly: The question now presented is whether if this court should determine that the claims of the intervener or the corporation are barred by any of these affirmative defenses in the nature of a bar, who would be left in possession of 10/14ths of \$4,200,000? All right, it seems to me, your Honor, the answer to that question fairly is that I am being asked now the effect *res adjudicata* of a judgment not yet announced by the court. I have no doubt but that this court in this proceeding is going to determine the force and effect, validity or invalidity of all

the several claims of the parties who are before the court. This is a court of equity. I think it is going to determine the whole controversy. I think when it has done so our views will prevail, we shall have judgment; but laying that aside, I think the question asked by counsel just now is academic in the sense that he is suggesting a judgment shall be pronounced by this court which will not be determinative of all the issues.

The Court: No, I do not quite get the situation that way, Mr. Adams. If this litigation concerned only the money having to do with the railroad company's operations, and that is all that was involved, you might be able to defeat that by one of those technical objections, and that would be the end of it. However, as I understand it, this litigation involves not only that \$10,200,000, but a claim that was filed by the corporation for \$4,000,000. Now, Mr. Levy argued that that is a claim of the corporation, and as a result of this settlement, which is really 10/14ths of \$4,000,000, the corporation is waiving its \$4,000,000 claim so that he has no res at all, that he would be entitled to get as a result of the settlement, and therefore he argues—I am not attempting to decide it now, but it seems to me it is plausible at any rate—the effect of that settlement that these two companies are going to make would be the company would be advantaged and the corporation would be disadvantaged because it would not have the opportunity to meet the technical defenses, which it could not meet in this entire res

that it claims it is entitled to, 10/14ths. He does not want the form of the settlement to put the company in the position of being able to defeat the action on the ground that it would not be able to defeat it on if the res were divided in proportion to the settlement that is being made. That I take it to be his point.

Mr. Levy: Exactly.

The Court: You say the settlement with the Government eliminates the corporation's claim and that is the way the settlement, itself, came about. You have asserted that. It is evident to me from what has been said, Mr. Levy and his associates are skeptical about that. They think maybe you maneuvered it that way. I do not say that that is so, but I get the impression from the arguments. If this be an equitable proceeding, I think everybody's rights ought to be protected so that no maneuvering or agreements that are made with the Government may bring about the defeat of the claim, without being given the opportunity to be heard. It may still be that that is the way the Government wants to settle it, and that is the advantageous way to do it, and the tax people have evolved this plan, which is a way to get this \$10,000,000 settlement out of the Government. On the other hand, I do not feel that I should necessarily restrain the settlement. I think maybe the thing might be worked out by some stipulation being entered into as a condition for not issuing or not stopping the settlement, because it may be an advan-

tageous settlement. I do not know. I do not want to make any agreement for the parties. They should make their own agreements. You might think this over a little bit, gentlemen. I am sorry, but I have to leave at five o'clock today. I have to catch my train. I had no idea this was going to take so long. If you want to come back tomorrow morning at nine o'clock I will hear you from nine to ten, but I have to go on with a criminal case. See whether you can't work the matter out a little further.

Mr. Adams: May I say, your Honor, of course it would not be the position of our clients to have taken any elicited or improper measures in connection with this transaction with the Government by which to obtain an advantage, and that is the furthest thing that was from our mind, and you may be assured, your Honor, that the form the settlement took was a form dictated by the practical necessities of transacting business with the Government. I think your Honor will wish to examine the stipulation, because I think your Honor will find——

The Court: I will take this stipulation home with me and read it over. Do you gentlemen wish to come back at nine o'clock tomorrow?

Mr. Clark: Your Honor, I would like to leave with you the original affidavit by Mr. Levy which forms the basis of this motion.

The Court: Have your opponents got copies?

Mr. Clark: I will give them copies right now once we file it, and I will ask your Honor to read it in connection with the stipulation

The Court: Has each side got copies of what you have handed me? Both sides will have copies of what has been handed to me is that correct?

Mr. Clark: Yes, your Honor.

The Court: Will you be here at nine o'clock tomorrow?

Mr. Clark: If we could have the engagement of these gentlemen that nothing further will be done than has been then perhaps we could set this for some day later in the week, which will be more convenient to your Honor.

Mr. Adams: Your Honor, it would be misleading certainly on our part to enter into such an engagement, when in our view the transaction with the Government is already complete, as in our view it is.

Mr. Clark: We had better go on at nine o'clock tomorrow, your Honor; because that has not been our understanding.

The Court: Maybe you will have further discussions with respect to this stipulation. I will continue the hearing until tomorrow.

(The further hearing of the matter was thereupon continued until tomorrow, Tuesday, August 26, 1947, at 9:00 o'clock a.m.)

August 26, 1947, 9:00 o'Clock A.M.

The Court: Do you want to present this matter further, Counsel?

Mr. Levy: Yes, your Honor, I would like to advert to a few items. Firstly, I would like to state to your Honor last evening my associates and I

drew up what we thought the stipulation in this case should contain. We have presented to our adversaries a copy of it, and I would like at this time to present your Honor with the original for your examination. (Handing a document to the court.)

If your Honor wishes, I will reserve my remarks until you have had an opportunity to examine it.

Your Honor will recall during the course of yesterday's argument I propounded a question to my adversaries, which to my mind represents the crux of this controversy on this application. The question was simply this: In the event this action is disposed of on the technical defenses, will the corporation retain possession of 10/14ths of the claim for refund, approximately three million odd dollars? In checking the transcript we found that either the question has not been answered, or Mr. Adams has answered the question in the negative, that is, that if the action is so disposed of after this settlement has been consummated, and in spite of the stipulations which have been drawn, it will be the railroad company which will have possession of that three million dollars. Now, if on the other hand, after the lapse of an evening, both of my adversaries should agree that the stipulation which they drew at least was designed to accomplish the result so that the corporation would retain that three million dollars, then, as I read it, the stipulation does not accomplish that result, but lawyers can sit down and we can draw a stipulation which will accomplish a satisfactory result to all parties as well as to your Honor, and that stipulation which

I have presented to you we think does it in clear, unequivocal language, so that there can be no further debate in the future as to whether it does or does not.

We stress this necessity for clear, unequivocal language I think not out of an excess of suspicion or caution. We have related the background facts that we think make it necessary for us to be in this proceeding. Your Honor will recall that the corporation never brought an action against the railroad company to share in these tax refunds and tax savings until our stockholders brought the action in the Southern District of New York. Years had elapsed since the consolidated tax returns have been filed, since the claim for refund had been filed; never had the corporation taken any action. It was only after we had launched the action in the Southern District of New York that the corporation took any action, and I believe the record which we have established in our depositions in the action in the Southern District of New York shows that it was our action in New York which caused the corporation to bring this action in California.

Let us carry that a step further: Take the very stipulation which has been submitted by Mr. Goodrich and Mr. Adams. Your Honor will notice that the only parties to that stipulation, although it be a stipulation in this action, are Mr. Adams, Mr. Goodrich, and the other defendants. The plaintiffs in intervention, who have contributed most to the commencement of this action, and the pressing of

this claim, were not advised of the stipulation, were not consulted in its draftsmanship, and were not even to be made parties to it. That makes me suspicious, and that makes me insistent on caution and clear language.

Furthermore, the original offer of settlement to the United States Government was made in February, 1947, and it is not until three weeks ago that the corporation sits down with Mr. Matthew and Mr. Adams in an effort to arrive at a stipulation as to what to do with this settlement in the event that it is accepted, and in that intervening period, before these discussions had commenced, we had written a letter to the corporation and to Whitman-Ransom, stating we felt we should be participants in these negotiations, and at least we ought to be advised of what has occurred. In the face of that record it is our contention that this corporation will be prejudiced by the form of this settlement unless the settlement is so divided that we will retain our share of the proceeds as if the United States Government had paid us directly, as it would have done in the normal course. Then we will be prejudiced, because these affirmative technical defenses of the railroad company can not only defeat our action with respect to what they have retained but will defeat our right to the entire amount of the tax savings since the action will involve only what they possess. We will be left with what the lawyers like to call the right without the remedy, and it is as good a way to be dead as any.

I would just like to point one further thing out to your Honor: In the corporation's complaint in this very action the corporation details the fact that there is a tax saving and a claim for refund, and it says, "We wish to submit to the court the question of allocating both of those as between the parties and determine the rights of the parties should it be found the corporation would be entitled to get the refund proceeds from the Government," and then as part of its relief the corporation says, "We pray that the parties hereto be enjoined and restrained from disbursing any funds in or coming into their custody or possession and constituting the refunds and reserves referred to in this bill of complaint, except upon the order of this court."

Now, what this settlement in its present form is doing is in actual fact transferring from the corporation to the railroad company the claim for a refund as reduced by the settlement. Now, the change of heart that has brought this about we cannot understand, but we can readily see the great prejudice which will result to the corporation if that kind of transfer is permitted, and we submit that the requirement, the damage, the injury is great enough so that this court at this time should sign the temporary restraining order, and we hope will ultimately sign the injunction pendente lite to prevent this transfer and the resulting prejudice.

The Court: I have not heard anything really from the plaintiff in this case, Mr. Adams. I do not wish to be sarcastic about this matter, but I would

think that if I were the attorney for the plaintiff I would be shooting off both barrels of my gun and would not be loath to accept advice from anyone who would help me maintain my cause, and I do not understand why the plaintiff in this action, who has brought the action, and who claims that the corporation is entitled, rightly or wrongly, to some part of this refund is not more enthusiastic about urging that very step be taken that would preserve the status quo, so that equity might properly resolve the rights of these parties. That is a subject that concerns me somewhat in this case. Here comes the intervener and he appears to be fighting both the plaintiff and the defendant in this case, and both parties, plaintiff and defendant, seem to be agreeable that the settlement should be made with the United States by which the claim of the corporation is disallowed and that of the defendant company is allowed, and that is a strange situation.

Mr. Adams: If your Honor desires, I would step down; but I take it my client is the adversary of both of these parties. My client is the party against whom this motion is brought, and it therefore is incumbent upon me, speaking for my client, to state the ground of our position. As far as the corporation is concerned, the corporation is our adversary, your Honor, and if your Honor would prefer to hear from the corporation first, of course, I would gladly step down for that purpose; but I think it should be borne in mind that your Honor has not yet heard argument in behalf of my client, the ad-

versary to these parties. We will, of course, present the argument.

The Court: What is the serious objection to having the matter so arranged, either by order of the court, by injunction, or some other adequate order in equity, so as to preserve the rights of all the parties in such a way that the court might proceed to adequately dispose of these claims, whether they be good, bad, or indifferent in an equity decree? How is anybody going to be hurt?

Mr. Adams: I can answer that question, I think, your Honor, but I think it would be most effective if I were to present my argument, because my argument, and the whole of it, is an answer to that question.

The Court: All right, go ahead.

Mr. Adams: I bear in mind the question which the court has asked is in effect. What is the damage or injury which might be done to Western Pacific Railroad Company, the party for whom I speak, in case the injunction or temporary restraining order now asked by the interveners were to be granted?

First, let us see what is the injunction which is asked, your Honor. These are the papers which were served upon us yesterday afternoon during the court session, and I read from the Temporary Restraining Order in the form as presented to the court: The injunction that is asked is an injunction against consummating with the United States Government the proposed settlement of the tax saving

for the years 1943 and 1944, and refund claim for the year 1942, as described in the aforesaid affidavit of Julius Levy. It is an injunction asked against releasing the United States Government or withdrawing or consenting to the rejection of, on behalf of the defendant in intervention corporation or otherwise its refund claim for the year 1942 in the approximate amount of \$4,200,000, or any part of such proposed settlement or compromise, or otherwise, and finally against taking any steps whatsoever to carry out or effectuate such proposed settlement, or the release, withdrawal or rejection of such refund claim.

That, your Honor, is the injunction which is asked in this case, and the answer therefore to your Honor's question becomes, I think, more clear upon looking at the injunction, namely, that \$10,000,000 is the damage or loss which our corporation would sustain, my client would sustain from the granting of the temporary restraining order that is asked here in court. I would like to make that clear to you, and for that purpose to state the origin of these tax claims so that the court may have the matter in mind. I think I may have failed heretofore in making that clear. We bear in mind that the defendant, Western Pacific Railroad Company, is the company reorganized right recently in the bankruptcy court in the Southern Division, Northern District of California; that that corporation represents a corporation which has been reorganized, reconstituted, as to which many claims hereto-

fore in existence have been barred, and swept aside. It is a fact (and it so appears from the reorganization plan) that the only parties who participated in and have any interest in the reorganized company were the Reconstruction Finance Corporation, the R. F. C., a Government institution, and the First Mortgage Bondholders. The corporation here in court was the parent company of our client, the reorganized railroad company. During the proceedings, in that reorganization proceeding, which lasted from 1935 to 1945—and in fact the final order was early in 1946—it had its day in court, and it urged in many forms, and repeatedly, the existence of equities belonging to it as against my client, the reorganized company. All of those claims were found to be wanting. The Interstate Commerce Commission found them to be without equity or value. The District Court of the United States in bankruptcy so determined. The United States Supreme Court, in 1943, affirmed the plan and repeated those determinations, and held that there was not enough in the properties of the debtor company, the Western Pacific Railroad Company, to make whole the first mortgage bondholders. That is the company of which I am speaking, and in consequence of the reorganization plan, and not otherwise, the corporation here in court arises out of holders of any equity or interest in this reorganized company. So then when we come into court we are aware of, and we feel, and we think we are correct in feeling we are responsible to the orders, the bars, and the injunctions of the bankruptcy court in respect to this reorganized

company, and it is one of our defenses in this litigation, and one upon which we believe we will prevail, that these claims have been barred, adjudicated, and swept out of existence, if there is any merit in them, by the effect of those reorganization proceedings.

The Court: These claims were during the reorganization proceedings? I notice they refer to the tax years 1942, 1943 and 1944.

Mr. Adams: Precisely. Now, the fact there is this: Beginning in 1920 or thereabouts, and for all the period in which consolidated income tax returns have been permitted, the affiliated group, consisting of the parent corporation, my adversary here in court, the defendant company, my client, and other corporations, members of the affiliated groups, filed consolidated income tax returns. That was the practice. During many of those years there was no income tax shown, no tax payable to the Government. During some of those years the corporation, my adversary, showed on its own account taxable income, but the railroad company, my client, showed on its account tax losses, with the result there was no income tax, no claim voiced then, your Honor, on behalf of our client that the corporation should pay our client on account of tax savings earned through our losses. Oh, no. It is only when the shoe is on the other foot that we hear that suggestion advanced, as we do here in court.

The Court: May I interrupt you to ask you this question: I take it that these consolidated returns covering the years involved, 1942, 1943, and 1944,

were returns that were filed jointly by the corporation and the trustees in reorganization?

Mr. Adams: That, I think, is the legal effect of it. The form in which the returns were filed, your Honor, was in the form of a return by the parent corporation, which is the form the regulations require, and of consents filed by each of the other members of the affiliated group, and as far as our client ever was concerned, informed, that consent was a consent signed "The Western Pacific Railroad Company."

The Court: The company and the corporation filed the joint returns during the period of the reorganization?

Mr. Adams: But I think your Honor's first statement is more accurate.

The Court: Was there any claim ever made during the reorganization proceeding of the same nature of the claim asserted in this suit?

Mr. Adams: That is one of our defenses.

The Court: You say it was?

Mr. Adams: No such claim was advanced. The fact is the trustees of the bankruptcy court were running this property during all the tax years in question, 1942, 1943, and 1944.

The Court: That is one of your defenses. I did not mean to interrupt your argument. I wanted to clarify my mind. One of your defenses is that because of the reorganization proceeding, this claim was washed out as a part of the process of reorganization, as it were, by reason of some fact, either failure to present it or some other ground.

Mr. Adams: Your Honor, this claim which rests before this court for \$14,400,000, and will now relate, in consequence to the settlement with the Government, to a claim for \$10,000,000, is a claim which could by no possibility survive the reorganization without having been presented to the reorganization court in total, and as to that defense there is no difference whatever between the refund claim and the balance of the tax saving which resulted from no tax being paid.

I would like to state, your Honor, a little bit more about the way these taxes worked out. In 1942 the trustees had taxable income. They ran the railroad and they made taxable income running the railroad for the court, and the trustees paid the \$4,200,000 out of assets belonging to them as trustees of the court. It is that money that the Government had. The corporation never contributed one dime, your Honor, to any of this. It is our client's money, the court's money that they are now seeking to make some distinction about. Now, the reason why the corporation is now the nominal party in the claim for refund is that under Regulations 104 and 110 relating to consolidated income tax returns, it is prescribed that the parent corporation, or the former parent corporation, as in this case, is the agent designated for all members of the affiliated group to make claims for refund. But the fact is, your Honor, that the moneys sought to be refunded was all trustees' money, paid by the trustees in discharge of their liability to the United

States for taxes, and claimed back by virtue of the loss relating to consolidated returns.

The Court: I recall this argument being made at the time of the intervention. I do not think there is any dispute about that. As I recall it, it was the intervener's claim that the plaintiff corporation was entitled to get something, because by its joining in and making this claim on the consolidated return, it resulted in a saving to the company which otherwise would not have been made, and therefore it was entitled to get something for that, and hence the invocation of the equity power of the court to decide what would be fair.

Mr. Adams: I think your Honor has stated it fairly, and one of the answers which we believe to be simple and to be most cogent to any such claim may be stated in this fashion: The corporation stands in this court, and the interveners stand in this court, speaking for the corporation, asking for money they never had, which never belonged to them, which they never paid. And upon what ground, your Honor? Solely upon the ground that they claim that they had the right to decide, by filing or not filing the consolidated return, whether or not my client would pay the Government. Now, that claim we contend, your Honor, appeals to no doctrine of equity. It is unconscionable in its nature. It is, in effect, a claim that, by some peculiar quirk of the tax laws, a party who has nothing to gain or lose, received under the tax laws a right to extract a price for determining whether or not

another party should pay the Government. There is no equity in that. Fundamentally, this claim advanced here by my adversaries is unconscionable. That is one of the bases.

Now, your Honor, what is the reason why this claim was never advised until, as counsel for the interveners have said, they, themselves, instituted litigation in New York? I cannot fully answer that, but I can suggest to your Honor that no one ever thought about it, and I can assure your Honor that when the trustees and this court employed Mr. Polk, as they did, the bankruptcy court, and when the bankruptcy court allowed the special employment of Mr. Polk as an expert, and when the bankruptcy court directed the trustees, as it did, to set apart the \$7,000,000 as a reserve against possible tax liability to the United States, and that the bankruptcy court did, so that the bankruptcy court was dealing with this important question of possible tax liability, I say when the trustees and the court did that, they never dreamed that the corporation would make such an unconscionable claim as this. No one ever thought about it, because in the nature of things it was not the sort of thing that anyone would expect to hear. In any event, the corporation was presently before the court. It was represented by eminent counsel, Judge Sloss. Judge Sloss carried to the United States Supreme Court the corporation's claims in equity, but he did not advance this claim. Oh, no, this claim is only brought up, your Honor, by stockholders representing, say, 2 per cent, whatever the per cent may be, of the

total amount of outstanding stock, which stock they purchased after this reorganization was well in process, and at prices which are a mere bagatelle. This is an afterthought suggested by the stockholders who now intervent in this court. I appreciate your Honor giving me the time, so to speak, to attempt in a rough way to state our own background of this thing.

I would like to come back to your Honor's question: What harm might be done if this injunction were granted? I stated to your Honor yesterday, and I have confirmed today through telephone communication with Mr. Polk, who is the attorney in charge, that this settlement with the Government is an accomplished thing. It has been done. It is a settlement agreement between the taxpayers and the Government. The Government and the taxpayers have determined their respective rights and liabilities. Those have been liquidated. The Government has kept \$4,200,000, an amount which our client or the trustees, as I stated, paid some years ago, and in return the Government has determined that that is all that it will keep on account of the tax liabilities for those three years in question, 1942, 1943, and 1944. I take it that in the absence of the United States as a party to this action any interference at this time with that settlement would be inappropriate. We suggest that to your Honor. But I would like to state in that connection right now, as well as I may, that the form the settlement took, your Honor, was not, as I said yesterday, in anywise

dictated or influenced by the relative positions of the corporation and the company. I think I can make that clear. I will try if your Honor will permit me. I asked Mr. Polk this morning the question, "What are the reasons why this settlement took the form of an agreement on the part of the taxpayer to relinquish the fund claimed and an agreement on the part of the Government to close the returns for the subsequent years as filed, bearing in mind the returns for the subsequent years as filed showed no tax, and that the refund claim was a claim for refund to the moneys previously paid?"

The reasons, Mr. Polk stated, are these: I will state them as well as I can and I think I can be accurate about them. By a settlement which is made in this form, under which the returns as filed are closed by the Government and the claim for refund is denied, the settlement is accomplished after the following procedures by the Government: First, a review by the revenue agent in charge, the agent in the field, supported by a review by his technicians. That is the first step the Government took in this matter.

The second was a review by what is called the Post Audit Section in Washington of the Internal Revenue Bureau; and there was a third review by the technicians of the Deputy Commissioner of Internal Revenue. Those were the steps to which the Government's processing of this matter went, and which resulted in the decision which has come down from the Bureau of Internal Revenue.

Now, then, had the settlement, instead of being in this form, been in the form of a proportionate allowance of the refund claim and a proportionate determination of sufficiency for the subsequent years, which is the suggestion counsel advanced, then in addition to that procedure the following would have been required:

First, another review by the opposite General Counsel of the Commissioner of Internal Revenue, followed by a recommendation by the General Counsel to the Commissioner of Internal Revenue with respect to that procedure and those determinations; the issuance of a public letter by the Commissioner of Internal Revenue with respect to those decisions; the rendition of a report to the Joint Congressional Committee on the Internal Revenue—I am not sure I have the precise title, but it is a Joint Congressional Committee. It has a special staff of its own, which then studies and reports to the committee upon the proposal. The report must lie with the committee for 60 days and, of course, at any one of those stages in the subsequent proceedings which would have been required if the settlement had taken the form which counsel suggests there could have been a decision on the part of one or more representatives of the Government that, instead of closing this matter, as it is now closed, it would be preferable for the Government to litigate. In case this claim were to be litigated it involves—I am trying to repeat Mr. Polk's words—your Honor will understand this matter I have

not handled—it would involve important and complex questions both of law and fact. For example, one question as to the date year of the loss of the corporation, which was fully argued and considered by those representatives of the Government who passed upon this matter, and other equally important and complex questions would have been involved. So that if the settlement had not taken this form it might well have been that after five years or more of litigation, extending through the United States Supreme Court, there would be a decision either that the taxpayer had \$14,000,000 to pay, or nothing to pay, or something in between.

The judgment has been expressed here by all parties concerned, your Honor, that a settlement of that potential tax liability at a figure of \$4,200,000, which is the effect of the settlement, is a wise and judicious thing. No one has questioned that. Furthermore, so far as the Government is concerned, the Government has acted through its several agencies after a full consideration of the matter, and has likewise determined from the Government's point of view it is a wise and prudent thing to appraise all of the chances, possibilities in this matter at the figure which the settlement determines. That is the background, your Honor, upon which I made my statement yesterday, or rather, it is a stronger background upon which I made my statement yesterday that this form of settlement was in nowise dictated by the considerations of the relative interests of the parties in-

volved. It was not. It has been criticized, however, because it may have that effect. But what does the criticism come to, your Honor? I take it your Honor has read the stipulation which we presented to your Honor yesterday. I take it that the stipulation which was presented to your Honor you have seen.

The Court: Yes, I read it last night.

Mr. Adams: Now, that stipulation was the result of some intensive work, occasioned by representatives of the corporation coming to us as representatives of the company, suggesting the very same problems that are now suggested in court by counsel for the interveners, and we think that stipulation answers those problems.

The Court: Has that stipulation been signed, gentlemen?

Mr. Adams: The stipulation is a binding compact in this fashion, your Honor: We prepared the stipulation. We submitted it to Mr. Goodrich, who forwarded it to his associate, Mr. Nicodemus, in New York. The Board of Directors of the Corporation were then meeting with respect to the matter of this income tax claim which was pending. We received from New York a request for a confirmation of our commitment to make the stipulation and we sent this telegram on the faith of which the directors of the corporation then acted. This is the telegram, your Honor:

“Responsive to request of Goodrich for answer to your yesterday’s telegram to Matthew, this will

confirm our commitment that if corporation approves and Government accepts pending proposal for settlement tax liability, we will join with you in execution of stipulation in form prepared by us and forwarded to you by Goodrich."

Mr. Levy: May we have the date of that telegram?

Mr. Adams: August 13th. That evidenced our commitment finally. That day the corporation acted upon it, and we are bound, your Honor, just as we are bound to the Government by the settlement of the tax liability made with the Government. So likewise we are bound to the corporation by the terms of the stipulation which we made.

The Court: It is your purpose to sign this stipulation when it comes back signed by the corporation, is that it?

Mr. Adams: Our purpose is to sign this stipulation, and we are awaiting the receipt of a formal document to be attached as an exhibit. That is the only reason it is not now signed.

The Court: I see. Exhibit A.

Mr. Adams: Yes.

The Court: The settlement agreement with the Government.

Mr. Adams: Yes.

The Court: I do not want to interrupt you, but time is running on in this matter. I take it, as I have read these two proposed stipulations, that the difference between the stipulation that the interveners want and the one you prepared is they want

to have this money in their possession. Off-hand, I would think that if they did not put it up they would not be entitled to have it in their possession, and the court would certainly have to adjudicate that they had some right. So I do not know whether I would be willing to go with counsel for the interveners to the extent that they would be entitled to have possession of this money.

Mr. Adams: May I say, your Honor, as to that matter I believe, however, if the interveners desire to press that question they could bring before your Honor in regular course upon motion and upon notice to enable us to prepare for it, any demand of the character suggested, and your Honor would pass upon it, but what we have before your Honor this morning in this quick fashion is a request for an injunction to interrupt the consummation of an agreement with the Government.

The Court: Which both sides agree is an equitable settlement of claims for the Government.

Mr. Levy: There would be no need for an injunction, your Honor, if the proper kind of stipulation was signed. May I address myself to your Honor's observation that since we did not put up the money we ought not to retain possession. To begin with, your Honor, you must keep in mind that we are at present, if there were no settlement, we would be the normal recipients of the Government's check on this refund claim, and then this court in the action which is pending before it would have to determine whether or not we are the owners

as distinguished from the possessors, and in that way, in the normal course we would be in the position of the possessor and the litigation would determine who was the owner.

The Court: Yes, but wouldn't you first have to establish in the equity suit the right to get a part of this money?

Mr. Levy: That is what we want to do.

The Court: Before you would be in the position of being the possessor of the money?

Mr. Levy: No.

The Court: If I were to order this agreement to be made, assuming I had the power to do it, I would be in effect transferring possession of this money before it was decided whether you were entitled to it.

Mr. Levy: No, sir. Let us pretend that there were no settlement. Let us pretend that the United States Government tomorrow said, "All right, gentlemen, we have examined your tax returns for the years 1943 and 1944. They are fine. You did not pay any taxes. You were not supposed to. We have examined your claim for refund. You are entitled to it."

Who would get the check? The corporation. So we are not asking your Honor to do anything other than what would normally occur in the normal course of events when we present a claim for refund to the United States Government. On the other hand, what this settlement does is this: It deprives us of possession of any part of that refund claim, and this is not merely a technical difference,

as your Honor appreciates, because of the technical defenses we could not get to first base in an effort to have you determine the merits, because the railroad company, after this settlement, having possession of the contested res, could defeat us on limitations, on laches, and on the injunction bar, and we would have the right, without the remedy.

The Court: I am not so sure that equity could not go through that in the final determination of this matter, and if the situation is as you say, and a settlement were made in such a form that the money would be paid to the claimant in refund, but because of the form of the settlement it is not made in that form, and then the technical defenses that you mentioned were made, a court of equity in making its ultimate determination of this matter, if it were necessary to pass upon these technical claims—I am not so sure that equity hasn't the power to look through that and say that that technical defense is defeated, if that is the only basis upon which the claim is defeated, and must be defeated because of the form in which this settlement of the claims with the Government was made. I do not think equity is so helpless as to be put in that position.

Mr. Adams: May I address myself to your Honor's question? I would like to read the provisions of the stipulation to which we have agreed. On page 2, paragraph B, is the following:

“More particularly the claim for refund of taxes paid for the year 1942 shall not be deemed to have

been abandoned by the settlement, but on the contrary the refund claim shall have been deemed to have been diminished in the proportion in which the aggregate of the tax savings involved in this action shall have been diminished by the settlement, and as so diminished to have been allowed, paid to the plaintiff as agent for the affiliated group designated in Regulations 110 and by the plaintiff paid into court, and the tax savings for the year 1943 and for the first four months of 1944 shall be deemed to have been diminished in like proportion. Nothing herein contained shall obligate any party hereto to make any deposit or payment into court."

Your Honor, nothing could be clearer than the statement here that it is agreed on our part that this tax settlement with the Government shall not have the effect of an abandonment of the refund claim as between the parties but, on the contrary, it shall be treated as if it had been proportionately allowed. That is all that is expressed there.

Mr. Levy: Mr. Adams, under this paragraph, if this court should determine that the plaintiff is barred by the statute of limitations, or the injunction, or laches, who will become the possessor of 10/14ths of four million two? The railroad company or the corporation?

The Court: That is not the point I just stated.

Mr. Adams: That is not the point.

The Court: The court could not, in my opinion, determine that the plaintiff is barred by these

technical defenses solely by virtue of the manner in which this claim for refund was handled, but if the plaintiff is barred by laches or some other claim in a manner and by virtue of facts and circumstances apart from the manner in which the claims with the Government were settled, then you would be barred. That is all there is to it. It would not make any difference whether you had the money in your possession or not.

Mr. Levy: By gosh, your Honor, here is a lawsuit that has hazards. Here are defendants and a plaintiff who sit down to make an agreement because they have got to make a settlement with the Government that they think is advantageous. Instead of taking the form, at least internally, whereby they eliminate a hazardous question, namely, the power of equity to ignore the statute of limitations, to ignore an injunction bar, they deliberately avoid taking that course. Now, what harm can come to these defendants if they give to the corporation what would normally come to it from the United States Government if this were not settled, or if the settlement took the usual form? Why should the court be burdened with a difficult problem?

The Court: They may be afraid of you New Yorkers and figure if you once get your hands on this money they will have a terrible time getting it away from you.

Mr. Levy: We are depositing it right in court, your Honor. It goes right into this court.

The Court: We might treat this matter this morning in the nature of a pre-trial conference as well as an application for preliminary injunction, and the court might, it seems to me, dispose of this matter, not by the granting of any injunction, because I do not think this court should, for the reasons stated, at any rate, prevent the consummation of what the parties agree is a sensible settlement of the claim to the Government, but I do think that the court can, treating this as a pre-trial matter, make an order in which, on the basis of the stipulation made or about to be made, the rights of the parties, in view of our discussion this morning, may be so protected that irrespective of the form in which the settlement of refund is made, the parties would be in a position, at least the plaintiff would be in a position, at least the plaintiff would be in a position to assert its claim urged in this suit with the same force and effect as against any technical defenses as it would have been able to assert those claims had it been in the possession of a portion of these funds, and in that way it seems to me equity would adequately protect the rights of all the parties. I do not see how you possibly could be not protected.

Mr. Levy: May I show you how, your Honor? I am trying to think along with you and this occurs to me: We are trying to project now what hazards may come during the course of this lawsuit, flowing from an unnatural way of making a settlement rather than a natural way.

The Court: Counsel has made a statement as to some reasons why in the settlement of the tax matter this was a more practical and adequate way of disposing of it.

Mr. Levy: But that did not prevent the parties from sitting down and saying, "O. K. We have both gotten the benefit of this matter. Now, let us give each the benefit of protecting each party to this litigation."

The Court: Doesn't the stipulation and the order of the court in which you are going to adjudicate the equity matters protect you? You would not get any advantage by my enjoining the consummation of this refund matter. You might kill the goose that laid the golden egg by doing that. But if this is the court that is going to adjudicate your rights eventually, and if this court makes a preliminary order in a pre-trial conference and it is backed up by this stipulation of the parties, which serves to eliminate any unconscionable procedural advantages that might accrue to your opponent as a result of the manner in which this refund settlement is made. That is a proper exercise of the powers of equity, and it serves to protect you, does it not?

Mr. Levy: Your Honor, take another look at that stipulation. The paragraph which was read to you creates a fiction. It says, "It shall be deemed this money had been paid," but it is not actually paid to the corporation. And look at the other provisions of the stipulation. It goes on

to say the defendants have all the defenses with respect to the tax savings as reduced by the settlement. In other words, whereas laches previously would not have applied to our right to retain what we had in our possession, under that stipulation it now does apply, because the amalgam of the contested res is reduced to the ten million one. Now, you say, "How can we be damaged otherwise?"

Let me pursue that a moment. Assuming each party had in its possession what it would normally possess if the Government had approved the tax returns and paid the refund, and assuming that this court evolved this theory of law, and it is not unusual, that the parties had no agreement as to how the tax saving should be shared. The railroad company possesses then ten million one. The parties have no agreement as to how the refund should be shared. That has been paid to the corporation by the Government. Now, equity, in view of the fact that the parties had made no agreement, equity says, "We will leave the parties where we find them." That is a possible conclusion of this court that I am hypothesizing, and if that were the conclusion of the court the railroad company would be left with the ten million one hundred thousand dollars and the corporation would be left with the four million two hundred thousand dollars. This settlement makes that conclusion impossible because only the railroad company has the \$10,100,000. We do not have the \$4,200,000, so that to our mind is a hazard.

The Court: Mr. Levy, I am not particularly impressed by that, because in making an adequate determination finally in equity the court is not going to make the kind of decision that has a definite purpose behind it and yet find its purpose defeated by the very thing that you are talking about.

Mr. Levy: But your hands are tied, your Honor.

The Court: I do not think equity's hands are tied in a matter of that kind. The court is going to make the kind of judgment that, if that obstacle presents itself, will take care of it, go through it.

Mr. Adams: I take it this court will command the situation and do justice and equity in its final decree.

The Court: I will say here, and you may treat this as a pre-trial conference and the reporter is taking it down, that both sides have presented their views, and I know what the purpose and object of the interveners is, that their rights may not be prejudiced to the procedural advantage of their opponents by virtue of this settlement. The court will make a pre-trial order, which counsel can prepare, to the effect that the court, in the ultimate equitable determination of this matter, will be guided by what has been said here this morning, by the stipulation of the parties, and that final determination will be made in this matter without giving effect in any manner, procedurally or otherwise, as far as the rights of the parties

are concerned in and to this fund, to the proceedings for refund with the United States. Now, what more would you need?

Mr. Adams: I take it, your Honor, that that order would run equally to the advantage and benefit of each and all of the parties.

The Court: Of course, I am not trying to determine the rights of either party at this time.

Mr. Goodrich: Your Honor, may I add this, that the very thing Mr. Levy has been contending for here is the thing Mr. Nicodemus and I went to Mr. Matthew's office to contend for, and our first request was that an amount of \$4,200,000 be laid aside and earmarked especially for us to distinguish possibly between these technical defenses applying to the money that had been paid in to the Government and the technical defenses that might apply to the money that had been reserved but not paid. The railroad company did not feel that it could do that, and we spent three days in the working out of this stipulation, and I think it was the consensus of the attorneys who were present that it had precisely the force that your Honor has expressed here, and that it preserved the situation exactly as it was, leaving it to the court finally to do equity among the contending parties. The fund is diminished by the settlement with the Government but proportionately to the balance that is left under this stipulation, as I understand it, the rights of the parties are precisely what they were before.

The Court: I think I adequately understand this matter. I know counsel might want to pursue it much further, but all that the court has before it is whether or not it should take some action at this time by way of extraordinary equitable order, and I feel that an order denying the application for restraining order upon condition that the stipulation that is represented to me is signed by the parties and is sufficient to protect the rights of the parties hereto, and that that, coupled with the statement in the nature of a pre-trial order that the court has informally made, and which may be reduced to writing, should be adequate to protect the rights of the parties.

Mr. Levy: Your Honor, may I ask whether Mr. Adams consents to that informal pre-trial order?

The Court: I have already made it. I do not think it requires Mr. Adams' consent. I think an order along those lines in the nature of a pre-trial order, reciting briefly the nature of the contentions of the parties and the intent of the court to preserve the rights of all parties, with the same force and effect as if this particular settlement and agreement with the Government had not been made, is sufficient to take care of the matter.

Mr. Levy: I am thinking of an argument to an appellate court based upon some contention that your Honor's order is erroneous, and if Mr. Adams feels it is correct I think he could so state for the record now.

Mr. Adams: The court has made the order and I understand it to be so.

The Court: Have you any objection to that?

Mr. Adams: I am not now certain, your Honor. I take it, though, your Honor's order in this proceeding is an interlocutory order such as other interlocutory orders are, and as the case develops before your Honor, your Honor will make further and additional interlocutory orders, and your Honor's order is an order and not a stipulation, and your Honor's reference to a stipulation is to the stipulation which we have agreed to enter into.

The Court: That is right. I am simply making the condition of the denial of the restraining order the execution of this stipulation.

Mr. Levy: Your Honor has broadened the stipulation.

The Court: I do not think it is proper to ask counsel whether they want to consent to some order the court has made. Somebody else might look at it differently, but it seems to me it is equitable and will protect the rights of the parties.

Mr. Levy: Thank you, your Honor.

The Court: I am sorry I could not give you gentlemen longer, but I have another trial on.

Mr. Clark: May it please your Honor, in that Western Pacific matter which was heard the other day, the parties have agreed upon a form of order which we think meets your Honor's views as indicated at the close of the hearing, and everyone has consented to it and I will pass it to your Honor to sign.

Mr. Adams: Your Honor will bear in mind that in agreeing with counsel as to his statement, when he said "consent," he means we approve the form of order; but your Honor said the order was not one made upon consent of counsel.

The Court: It seems to me to cover the matter.

Certificate of Reporter

J. J. Sweeney, Official Reporter, certifies that the foregoing 68 pages is a true and correct transcript of the matter therein contained as reported by me and thereafter reduced to typewriting, to the best of my ability.

/s/ J. J. SWEENEY.

[Title of District Court and Cause.]

PRE-TRIAL CONFERENCE

Tuesday, January 11, 1949

* * *

The Court: I would like to interrupt you there a moment. From your point of view how important is the evidence concerning the so-called duality and domination issue in determining the legal question?

Mr. Clark: May it please your Honor, the intervenor believes that the issue of duality, if not essential to the cause of action, is of the greatest importance because, while it might well be as a

substantive question of law, and considering only the bare fact that the filing of the consolidated return and the use of plaintiff's corporation's stock loss as giving a right in the corporation, nevertheless if the directors representing the corporation were guilty of no dereliction, and that has simply been an arm's-length transaction between two companies properly represented, we think that there might be substantial doubt, may it please your Honor, that the Court could now go back and reappraise a good-faith corporate transaction. In other words, may it please the Court, the substantive question alone is the narrowest basis upon which this case could be decided. The facts are that instead of the holding corporation being represented by an arm's-length board of directors, the majority of its directors at the time of these transactions were employees of the defendant corporation, compensated by the defendant company; general counsel for the holding corporation was counsel for the defendant company; tax counsel for the holding corporation was likewise tax counsel for the defendant company; and each and all of those people were compensated solely by the railroad company. Now, in that view of the matter, your Honor, the holding corporation with respect to these transactions had no representation, and the interlocking directors and counsel between the two created the fact of the interlock resulting in these companies occupying a fiduciary relationship one to the other. And in addition to that,

may it please your Honor, you have these fiduciaries represented by identical counsel who, the evidence will show, advised one of them as to its rights, namely, the railroad company and not the other. Now, the result of that, if it please your Honor, is that on those facts the Court not only has the right but the Court has the duty to reappraise the transaction from the standpoint of fairness, and if the Court should find that transaction unfair, it has the right then to allocate the benefits to the respective company who is entitled to it. That is just on the merits.

The Court: Your point there is that it is necessary to present this evidence in this field of what you call duality of control because without it there might not be a cause of action?

Mr. Clark: Precisely. We believe it is essential to the cause of action, but should it not be, it at least, may it please your Honor, is the broadest ground on which a judgment in favor of the holding company can be supported, and we think it is a necessary ingredient in this case because of those other facts in this case.

The Court: What you are saying now is it was this domination and duality which produced an unfairness in the relationship that had its effect in the form of unfairness in the transaction with respect to these income tax returns?

Mr. Clark: The transaction, if it please your Honor, which resulted was, we contend, an unfair transaction from the standpoint of the holding com-

pany. The duality and domination entitles your Honor now to reappraise that transaction, and if you find it fair, to allocate the tax benefits to the parties in the proportion that your Honor considers fairness requires. The transaction itself is unfair inasmuch as on the filing of these consolidated returns a stock loss suffered by the holding corporation amounting to \$76,000,000 was used to offset the income of the railroad company and saved \$21,000,000 which it otherwise would have had to pay the Government.

The Court: I understand that. We have had some arguments in connection with this matter before. But I was wondering whether or not the unfairness of the transaction would not principally depend upon the nature of the transaction itself rather than upon who participated in it, why, and under what conditions?

Mr. Clark: Suppose, your Honor, that two independent companies were represented by arm's-length boards of directors and that they had sat down under those very circumstances and for whatever reason, and with full knowledge of the facts, the stock loss, the rights of the holding company not to file a consolidated return, had decided in their judgment—there being no showing of any dereliction on their part—that the proper thing to do was to file a consolidated return for old times' sake, let us say, and confer this benefit upon the railroad company. Now, if that were the case we have very serious doubt, if it please

your Honor, that these people, being competent persons all over twenty-one, acting at arm's length, and no dereliction on their part having been shown, we doubt very much that your Honor could step in at this time and reappraise that transaction.

That goes to the affirmative side of the case. In addition to that there are certain technical defenses here, the statute of limitations, laches, et cetera, to which the duality, let us call it, is the answer. So it also applies defensively as well as, we think, constituting an integral part of the case in chief, because, as opposed to the good faith example I have attempted to put to your Honor, let us take the facts of this case where there were no independent boards. There was almost a 100 per cent interlock right down the line, everybody being compensated by the railroad company. One of our directors, for instance, is a telephone operator in the New York office, director of the holding corporation, on the payroll of the company; with that kind of interlocking directorship represented by those companies, represented by the same tax counsel and the same general counsel, we have the facts respecting the mechanics of how this consolidated return was filed, amounting simply to this: that Mr. Coulson's firm prepared the returns which initiated this tax saving, and which set up the use of the corporation's stock loss, and that return was presented to Mr. Curry, our president, who was at the same time a vice president of the railroad company, who was given no advice whatso-

ever, made no inquiry whatever, simply signed his name; ergo, the railroad company saves for that year some \$8,000,000. In other words, the corporation was not represented, your Honor.

The Court: That is not exactly what I was thinking. We are only discovering this now from the point of view of trying to limit the issues and the evidence of the trial itself. Offhand it would seem to me, unless there was a cause of action that arises out of the transaction itself, it can't be transformed into a cause of action because the persons who have dealt with it were not nice people or even had bad motives. A cause of action either existed or it did not exist.

Mr. Clark: Right.

The Court: What you have to say might have some effect when meeting affirmative defenses because there you might have a question of estoppel, waiver or other matters that might prevent the assertion of some special defenses. But it would not be fair and right to allow the holding company to participate in the benefits of this tax refund; would not become right and fair because the people who handled them were grasping or otherwise did not conform to the standards that were considered proper.

Mr. Clark: Your Honor is quite right, and I have not made myself understood, apparently. The function of the duality is to enable your Honor to roll back the curtain and reappraise the transaction as though you were there the minute before

these returns were filed or accomplished in the manner I have described, and once that is done, then of course there has to be the cause of action or right in the holding company to these tax savings before your Honor can award them to them. The mere fact that there may have been a wrongdoing, duality or what have you, does not create a cause of action. Of course not. Now, once the duality rolls the curtain back so that your Honor has a right to remake the transaction from the standpoint of fairness, then of course our argument comes into play that under the spirit of the tax law the benefits, at least those flowing from the use of the stock loss, were rightfully the holding corporation's and not the railroad company's. Do I make myself clear?

The Court: Yes. I understand what you are getting at. I am not wholly convinced by it yet, but we have lots of time to get at that. It might be too confusing. After all, there are a lot of lawyers here and all of you have spent a lot of time on it and you want to throw a mass of documents and data in the lap of the Court on this question and we might be led astray or diverted into extraneous fields by these matters upon which there might not be any factual controversy at all.

Mr. Clark: No, so far as we are concerned, your Honor, and I have not got to that point—

The Court: Who these people are who were directors and all of that—I notice mention is made of that in some of the briefs—I suppose is no longer

a matter of controversy. They are what they were, and that is all.

Mr. Clark: That is right, and so far as the intervenor is concerned, your Honor—I had not got to the point in the statement—it is immaterial to us whether the matter is handled in the way Mr. Phleger proposes, namely, by admissions of fact, which are supported by the documents, and therefore the admissions would eliminate the necessity for the documents, or whether it is handled as Mr. Adams suggests, by the stipulation of these exhibits in evidence. We do not care, because we think either way accomplishes the purpose. I was simply explaining to your Honor my initial reason for my having requested 450 exhibits because I was quite sure the defendant would not make admissions of fact which would result in the elimination of them. Now, I have not examined Mr. Adams' response, but I dare say on many of these issues he is not willing to stipulate, and I just point out that that means that many more exhibits have to go in.

The Court: I wonder if we can't find out whether there is a controversy as to whether or not there was this duality of control. Maybe the defendant does not dispute that.

Mr. Clark: Well, Mr. Adams does not dispute, I think, if it please your Honor, the bare fact of position, but he does very definitely dispute, and has throughout the case, any improper motive and he also has disputed the idea of the domination

or misuse of the control over the holding company by the James interests. Of course, I am attempting to answer for him.

The Court: When you say the "misuse," are you referring now generally speaking or to the matter of this tax problem?

Mr. Clark: With respect to these very transactions, your Honor.

The Court: Is your contention that one of the purposes and objectives of this duality of control was to deprive the plaintiff, the holding company, of its right with respect to possible refund of taxes?

Mr. Clark: With respect to these tax savings, yes, your Honor.

The Court: Was there something else you wanted to add in this preliminary discussion?

Mr. Clark: That is all from us at this time, your Honor.

The Court: What have you to say in this preliminary stage?

Mr. Adams: Your Honor was discussing with Mr. Clark the question, as I understood it, whether the claim of duality, domination and control had any materiality to this lawsuit. It is clear in our judgment that those claims have nothing whatever to do with whether or not the plaintiff has a cause of action. We agree entirely with your Honor's statement that there must first be a claim brought into court.

The Court: Mr. Adams, I was not intending

to indicate that was my view on it. I was trying to explore the matter to see if it does have that effect.

Mr. Adams: May I say that is our view. Perhaps I misunderstood your Honor's question as in effect a preliminary indication of the way your mind was working, but it is clearly the law that there must be a cause of action before there can be a derivative stockholders' suit for the derivative stockholders to come into this court attempting to speak in behalf of the corporation and, of course, the corporation must have a cause of action.

Now, as regards duality, domination and control, I should like your Honor to understand why it is that if there are issues entered in this case of that sort it is necessary for us to ask that the trial of that issue be upon the facts and on no other basis. As your Honor suggested, we have certain affirmative defenses in this lawsuit. One of them is the bar of the reorganization proceedings out of which all these transactions arose, in which all of these transactions of which complaint is made took place. And I understand that the plaintiff in this case, as well as the interveners, joined in the contention that these facts of so-called duality, domination and control afford to them a basis upon which to escape the bar of the reorganization. Likewise we have pleaded defenses of estoppel, of laches, of waiver, and we have facts to back those up, and I understand these contentions with regard to domination and control and duality are brought

forward in order to enable the plaintiff in this case to escape the effect of those defenses. That is my conception of the place that these tendered issues have in this lawsuit.

Now, with regard to those issues, your Honor—and I do not want to take the time to go into detail about this—but I would like to say there is one basic uncontrovertible fact about duality in this case that is wholly and studiously ignored in our adversaries' briefs and in our adversaries' presentation, and that fact is this, your Honor: There is and never was duality between my client, the reorganized Western Pacific Railroad Company and this plaintiff corporation. What our adversaries constantly do and it is illustrated by the statement that Mr. Clark just made when he said that general counsel for the corporation was also counsel for the railroad company, what our adversaries do is wholly ignore the basic difference between the reorganized company that was reorganized in Judge St. Sure's court and was put in possession of properties on the 1st day of January, 1945, as the vehicle for the effectuation of the plan of reorganization, and the old debtor company which went into reorganization on August 2, 1935, and which was at that time suspended, or rather on the 9th of November, 1935, when the trustees were appointed. In 1935 the old debtor company's properties became the properties of Mr. Thomas M. Schumacher and Mr. Sidney M. Ehrman, the trustees in the reorganization proceeding, and for

ten years Mr. Schumacher and Mr. Ehrman had title to the properties, owned the properties, had the income, had the tax liabilities, and the debtor company was a frozen instrument of the equity and represented very properly by the general counsel for the plaintiff corporation here in court, and in that form as a spokesman for the equity.

Counsel constantly referred to the relation that Mr. Nicodemus had to the debtor company, as if that were a relation to the reorganized company, when the fact is that Mr. Nicodemus' employment, as counsel, came to an end with the end of the reorganization. By the same token counsel spoke of duality in the relation to other directors of the holding company, when the fact is that relation was a relation brought into the reorganization in 1935, continued while Mr. Schumacher and Mr. Ehrman were the court's trustees, and was a relation of duality between the holding company and the court's trustees, but not with my client, the reorganized company. I want to make that clear to your Honor because that gives your Honor some view initially of one of the reasons why we contest, and we contest all the way through, any suggestion that there were in fact dual relations between these complainants, our adversaries, and my client, the reorganized Western Pacific Railroad Company.

The Court: Would it be an embarrassing question to ask who controls the reorganized company?

Mr. Adams: The reorganized company, your Honor, is controlled by its own directors and I will state the facts to you.

The Court: No, I mean as to the stockholders. Do the people that these gentlemen complain about, who controlled the operating company before, still control the reorganized company?

Mr. Adams: No, they do not, your Honor. The control of the reorganized company rests—the James Foundation has the largest single stock interest. The control of the Western Pacific Railroad Company rests in stock ownership with the Reconstruction Finance Corporation formerly represented by Mr. Phleger's office in the reorganization proceedings, by the Metropolitan Life Insurance Company, by the James Foundation, and other stockholders in minor capacity.

Now, the board of directors, your Honor, of this company, seven of the board of directors are Western directors selected by Judge St. Sure in the reorganization proceedings as a part of the plan and selected initially and submitted to Judge St. Sure in the reorganization by the reorganization committee, constituted of Mr. Ecker, the chairman of the board of directors of the Metropolitan, Mr. Wright, the representative of the RFC, and Mr. Coulson, the representative of the James Foundation, those being the three largest stock interests. These seven Western directors, according to the plan, were required to be selected here in San Francisco and every one of them is an independent director.

The Court: Are they now the directors?

Mr. Adams: They are, your Honor. There has

been perhaps one change or so, but there is now on the board a representative of the RFC, a representative of the Metropolitan, two representatives of the James Foundation, and the balance the Western directors, just as when the Court——

The Court: What do you mean by the Western directors?

Mr. Adams: The Western directors, consisting of such gentlemen as Mr. J. Ruben Clark of Salt Lake City, Mr. J. W. Meyer, Jr., Mr. Folger, Mr. Bell——

The Court: Do they represent any particular interests?

Mr. Adams: They do not. They represent the Western Pacific Railroad Company and all its stockholders and they do not, any of them, represent any particular interest except in so far as they may be said to represent the community from which they were selected. There is no question about that, your Honor, and I do not think there is any contention made to the contrary in this case. I do not understand so.

* * *

The Court: I was thinking of the intervener, Mr. Phleger. How far part are you two with respect with what you need to present to establish this ultimate fact that Mr. Phleger speaks of?

Mr. Clark: May it please the Court, you have not been advised that the intervener some two weeks ago stated in writing to the defendant the limitation which we place upon the very broad issue of

duality which your Honor has just described, and the limitation which we intend to follow in the brief. On December 29 I wrote a letter to Mr. Adams and served all parties with a copy of it, in which I made this statement. I will hand a copy of it to your Honor so it may form the basis of a pre-trial order on this issue, if your Honor so desires. I advise Mr. Adams as follows:

“Except for such brief background as may be necessary for a proper understanding of the relative positions of the various individuals and other facts and circumstances as between the railroad company, the holding corporation and James interests, on and subsequent to January 1, 1943, we intend to limit the entire issue of duality, domination and control to the period commencing as of that date, to wit, January 1, 1943,” the reason being, your Honor, that we consider the critical period pertaining to these tax transactions to start on March 15, 1943, so we went back to the first of the year. Now, we have already advised the defendant, then, as to all background beyond that date, except that which is necessary for the purpose of illustration, that we are not going to develop that or rely on it. We are only going to develop the duality and domination which took place during the critical period with respect to these very tax transactions.

Now, we went on and said: “In addition to the duality of various officers, directors and counsel, the railroad company and holding corporation, plus the practical effect and pull under the circumstances

of the James stock ownership and the source of compensation of the corporation officers, general counsel and certain of its directors, as well as its entire office expense after June 1, 1943, we will further contend that during this period the holding corporation was completely dominated and controlled and misused by the James interests through Robert E. Coulson for the advantage of the railroad company and hence James, resulting, among other things, in the tax savings which are in issue here, the said Coulson at the same time being the agent of the railroad company with respect to this very same subject matter. This is the extent of the issue of domination as distinct from duality as we now view it. We do not believe there is any relevancy in whether or not the James interests ever attempted to dominate and control the railroad company or the reorganization trustees, and accordingly we do not intend to raise that issue."

In other words, we have advised Mr. Adams in writing that the only domination that we intend to attempt to prove commences as of January 1, 1943, and is the domination by the James interests per Coulson, trustee and attorney, over the holding company, while Coulson was also at the very same time the agent for the railroad company, the effect of such domination being to advantage the railroad company. I would like to hand this copy of the letter to your Honor.

It is immaterial to us whether this be incorporated in an amendment to our pleading, which is naturally

very broad because it is drawn at a time when we just came into the case and had not developed these facts, or in a pre-trial order limiting the issue, as we suggested in our letter. Now, I take it that that limitation on that issue is entirely consistent with Mr. Phleger's view of it, and with the statement your Honor just made, namely, it is such domination and duality as affected these very transactions of which we complain in this case.

The Court: Why couldn't the issue then be limited to what was done with respect to the preparation and handling of these various tax returns?

Mr. Clark: Plus also, if it please your Honor, the positions held by the parties of stock control——

The Court: You will show, I take it, what actually was done and who handled the matter?

Mr. Clark: Who they were.

The Court: How in general the matter of the filing of these returns was done. Do you have to go beyond that on any general question of duality or control?

Mr. Clark: I do not think we have to except as is necessary to identify these people.

The Court: Obviously it is not the situation or you would not be here, but I was wondering if they might have exercised full powers of control under a duality concept in every other respect than in connection with the tax returns.

Mr. Clark: No, we are concerned solely with these returns, your Honor.

The Court: Your complaint is because these

powers of control were exercised with respect to the tax returns, you have a cause of action?

Mr. Clark: That is right.

* * *

Mr. Clark: There was one further thing with respect to the interveners stock holdings. That is paragraph 2 of this stipulation that sets forth the amount of stock held by the interveners in the plaintiff corporation which qualifies them as interveners in the case. Certain exhibits are referred to which were produced on the New York depositions, and all of these figures have not only been verified by Mr. Adams through looking at the original records, but he uses them in his pre-trial brief, and we would like to have it stipulated to so we would not be put to our proof in bringing the stock certificates out here to prove the stock ownership of our clients.

Mr. Adams: You do not need the stock certificates. As we said last Friday, it will be stipulated that the stock holdings shown at the time of the deposition will be considered to be in force at the time of the trial.

Mr. Clark: That is satisfactory. The plaintiff gives the same statement with regard to that?

Mr. Phleger: We do.

* * *

[Endorsed]: Filed Mar. 11, 1949.

[Title of District Court and Cause.]

ARGUMENT ON MOTION FOR REARGUMENT AND TO AMEND FINDINGS OF FACT AND CONCLUSIONS OF LAW APPEARING IN THE COURT'S OPINION FILED SEPTEMBER 6, 1949, AND ARGUMENT ON MOTION OF PLAINTIFF TO JOIN RECEIVER AS PARTY PLAINTIFF UNDER RULE 25 (e) R.C.P.

REPORTER'S TRANSCRIPT

November 28, 1949

The Clerk: Western Pacific Railroad Corporation vs. Western Pacific Railroad Company.

Mr. Lasky: In that matter, if your Honor please, there are three different matters on the calendar. There are two motions and settlement of findings, I believe. The plaintiff submitted some proposed findings.

I may say that when this was set down for this afternoon last Monday I was a little tangled up and Mr. Phleger was out of the city. I left. I was out of the city last week, and when I finally saw him I discovered he was going to be away this week, but in view of the fact that Mr. Levy was going to be here, we concluded the only thing to do was for me to come out and present the plaintiff's position.

Mr. Levy has a motion here with relation to the findings, which raises one of the two major points which were raised by the plaintiff's proposed find-

ings. Since it is a matter peculiarly within the knowledge of Mr. Levy as to past occurrences in this court before our office came into the case, it seems to us to be appropriate that perhaps Mr. Levy might present his motion first, and then on behalf of the plaintiff I can supplement that discussion. If that meets with your Honor's approval, I am willing to have Mr. Levy go ahead first.

The Court: What motion is it you are speaking of? [2*]

Mr. Lasky: Mr. Levy has a motion; he calls it a motion to amend the findings and for reargument, I believe it is entitled.

Mr. Levy: Yes.

Mr. Lasky: It is not precisely a motion to amend the findings since your Honor has not adopted findings, but it does raise an issue which we have raised on our proposed findings of fact and proposed conclusions of law.

The Court: If you are going to have any argument about findings in this case, I may make my own and just use the opinion. I really do not think there is any occasion for lengthy findings in the case. I put in the opinion that if some counsel have felt there was something that I overlooked or if counsel felt there was some need to make a finding of fact that the court overlooked, I would not deprive counsel of that right, of course.

Mr. Lasky: If your Honor please, we have not

* Page numbering appearing at top of page of original Reporter's Transcript.

proposed lengthy findings of fact. We have submitted, I do not think it is more than four pages, and we adopt your Honor's opinion, or suggest the adoption of it, with a few additions which are material, I think, to the theory upon which the court proceeded; and I think after your Honor has heard the discussion of these objections you will agree that we have not gone out of or disobeyed the intimation of your opinion that we should remain confined to what you thought to be material. [3]

The Court: You think Mr. Levy should present his motion first?

Mr. Lasky: I think he should. I think it might be the most appropriate way to proceed.

The Court: Very well.

Mr. Adams: That is entirely agreeable, your Honor.

Mr. Levy: Our motion, your Honor, is a motion for reargument and a motion to amend the findings and conclusions as embodied in your opinion. We have not submitted any additional findings of fact or conclusions of law. Therefore, so far as we are concerned, we regard that opinion as embodying the findings and conclusions, and the only thing that I propose to raise upon this motion is something which is not mentioned in this court's opinion, is completely overlooked, I believe, and is of extreme importance.

As I read the court's opinion, the nub of the determination rests in your Honor's analysis of the transaction in its origin, finding, as you stated, that the tax savings which were the subject matter of

this controversy between this plaintiff and this defendant were erroneous and unjust, in reality the property of the United States government, and that, therefore, this court did not propose to commit the further iniquity of dividing as between these two parties monies which in fact belonged to a third party, namely, the United States government, and the court concluded that, therefore, the parties [4] would be left where he found them, where they were.

We do not propose to reargue any of the premises that are embodied in that conclusion. We have done a great deal of that, and your Honor has come to his conclusion, and for the purposes of this motion we accept all that your Honor has stated. But in determining where the court found the parties, and in concluding that the court was leaving the parties where it found them, namely, the plaintiff with none of the savings and the defendant with all of them, the court overlooked its own pre-trial order which was entered in just a little more than two years ago and which has gone virtually unnoticed in the course of the proceedings and has only become of importance as a result of the grounds upon which the case has been decided. Therefore, we present on this motion just one question: What is the effect of this court's pre-trial order rendered about two years ago in denying the interveners' application for an injunction restraining the settlement?

Before going into the details of the order and its

effect upon this litigation at its present stage, let me set the stage a little by projecting all of us back to that day in August of 1947 when we brought the motion on.

At that time the plaintiff in its complaint requested what amounted to declaratory relief, and it requested declaratory relief with respect to two distinct aspects of the tax [5] savings, namely, if your Honor will recall this, there were X dollars tax savings involved in the '43 and '44 tax returns. Those tax savings took the form of non-payment of tax, hence the defendant railroad company which had the income had in its possession monies which it did not pay.

In addition, another aspect of the tax savings was the refund claim. That was a claim filed by the plaintiff with respect to taxes in fact paid in 1942, and under the law, the internal revenue code, about which I am sure there can be no dispute, when the refund claim was paid or was to be paid, it would be paid to the taxpayer who filed the refund claim, namely, the plaintiff.

Plaintiff's complaint at that time requested that when and if these tax savings, namely, those in the possession of the defendant, and when, as and if the refund claim was paid over by the government in normal course to this particular plaintiff, that the court adjudge and decree that all of those savings or a reasonable portion of them were the property of the plaintiff.

Since as of those dates, the government had done

nothing, was in fact no seal of approval on the savings.

The intervener in turn had its interveners' complaint. The defendant in turn had an answer in which, with respect to the plaintiff's prayers and claims, it pleaded as defenses to the action, among others, laches, limitations, and the bar [6] of the bankruptcy order, and in addition it contained a counter claim. And in this counter claim the defendants said that this plaintiff has filed a claim for refund for '42 taxes already paid; when, as and if that refund is honored by the United States government, this plaintiff will receive that money, and another thing, the plaintiff may dissipate the money after receiving it; we therefore affirmatively ask for judgment against this plaintiff that when, as and if they receive that refund claim from the United States government, the proceeds belong to us. So that, in reality, you had two lawsuits involving the same cause.

Now along came the settlement or the proposal of settlement, and when we learned of it, your Honor will recall that we came out in great haste with an application for an injunction to enjoin its consummation, and in lieu of submitting the pendente lite restraining order without notice, we submitted it and gave informal notice to all of the parties concerned, and as a result we had a full blown argument on the question of whether or not a pendente lite stay should be granted, which in fact turned into an argument on the whole injunction

problem. Now just what was the settlement? Why did the settlement compel us to come out here and seek an injunction? To begin with, as your Honor may recall, we did not object to the amount for which the claim was being settled; but we did object to the form of the settlement, because the [7] form of settlement, as we viewed it in the light of the litigation, would be prejudicial to this plaintiff's position in this litigation.

Let us analyze that for one moment. The settlement with the government came down to this: so far as the '43 and '44 tax returns, as to which the defendant was in possession of all the money that had been saved by the non-payment of taxes, the government was accepting those returns as filed. Therefore, the defendant remained in possession of those tax savings. The settlement did not alter that part of the status quo. On the other hand, as a part of the same settlement, the claim for refund was waived, so that, so far as this plaintiff was concerned, it was thenceforth, forever and irrevocably denied possession of the funds represented by the refund claim, even though, in the normal course, had the refund claim been honored, the plaintiff would in fact have obtained possession. So that the settlement altered the status quo. [8]

The Court: I don't want to interrupt you, but I think that would have been equally as phony as the settlement that was made with the commissioner.

Mr. Levy: I am accepting your Honor's analysis.

The Court: And for the United States to have returned three million and some odd dollars to the plaintiff who in fact paid it for taxes that should have been paid, would have been even worse.

Mr. Levy: I am agreeing with your Honor 100 per cent on the premises on which you have decided this case, and I want to advert to that subsequently to demonstrate that had that been done, this motion for reargument would beyond peradventure have been granted, and in fact would not have been made. But this much occurred: the settlement altered the status quo to the extent of depriving the plaintiff of possession of any part of the tax savings in issue but gave to the defendant all of the tax savings in issue.

Now focus with me on the question of possession after this settlement was consummated. At that time we were seeking to enjoin it, and our argument was if that settlement is consummated, the entire res in issue in this case is lodged in the possession of the defendant and none of the res in issue in this case would be lodged in the possession of the plaintiff. The form of the settlement altered the normal possessory incidents that attach where you have a tax refund claim and any [9] other type of savings.

We urged to the court at that time that possession in this case was of great importance, and we did it to the limits that counsel could foresee what the future might bring. And we argued thusly: We said that the defendants have affirmative defenses, laches, limitations, the bar of the bankruptcy order.

All of those defenses are appropriate only where plaintiff has to sue the defendant to get any part of what it thinks it is entitled to. On the other hand, to the extent that the plaintiff may have possession of anything which the defendant thinks it is entitled to, to wit: the subject matter of the counter claim, then for the defendant to prevail against the plaintiff it cannot rely upon laches, it cannot rely upon limitations; it must affirmatively sustain the burden that it is indeed entitled to the proceeds which the plaintiff has in its possession. So that we said that possession, therefore, became a matter of the utmost importance in view of the state of the pleadings.

I argued that as vigorously as I knew how to, your Honor, and in the course of giving vent to what I guess was my womanly intuition that no lawyer in any litigation can foresee all of the eventualities, but knowing that never let your adversary get possession of something which you in the normal course would be entitled to have possession of, I argued that there were possibly further prejudicial incidents that would [10] flow from the form of this settlement. I argued that it is conceivable that this court might conclude, on a basis which I stated there and which has no resemblance to the conclusion of the court—it was possible that this court might conclude that it ought to leave the parties where it finds them in and I said, “If that is true, why then should we allow the mere form of settlement to alter the normal possessory incidents that

would attach to this transaction were the settlement made in a more usual form." And as a result of that, I said, "I think the way to cut the Gordian knot is to let the settlement with the government go through in the form in which it was proposed, but that vis-a-vis, the two parties to this lawsuit, because giving the plaintiff possession of a reduced portion of the refund claim just as if the United States government had in fact settled that claim for a reduced amount and in fact paid it to the plaintiff, and when the same suggestion was made that maybe the funds would be dissipated, I said, "Well, fine; pay it to us and we will promptly pay it to the clerk and it will stay in the court."

Now, your Honor, in response to that argument, as I understood it, took the position that interveners were indeed too concerned with formalism, if I may put it that way; we were too worried that the form of settlement might conceivably produce prejudicial results in the litigation. And your Honor properly stated that, as a court of equity, you would have the [11] power to ignore the form of the settlement, view the transaction as if the settlement had taken a normal course, as if plaintiff had possession——

The Court: Where are you getting this from? Some transcript of record?

Mr. Levy: Yes.

The Court: I thought that the parties had agreed pretty much on the form of the order that was made at the time.

Mr. Levy: On the ultimate form of the order, but not on the substance of the debate. I will come to that.

Let me pass that for the moment.

Your Honor reiterated that point of view, though, and then finally came to this conclusion: as far as you were concerned, you wanted to deny the injunction motion conditioned upon the execution of a certain stipulation which the court approved and the defendants were willing to enter into and which we said was insufficient.

The Court: Mr. Levy, I don't want to interrupt you. At that time you were arguing some preliminary motion in the case. I didn't know very much about the case then except that you were engaged in a question of discussing whether the status quo should be maintained or not, and I may have made some comments in connection with that matter that haven't any relationship to the final questions to be determined at the trial of this case.

Mr. Levy: No. I may have overly embellished what went on at that time, but only for the purpose of refreshing all of us. It is two years. We are not relying on the off the bench comments that the court made. That is not the basis of this reargument motion. What we are relying upon is the order that we made on this motion, and perhaps a short cut to all of this is to read the relevant portions of the order. Now here they are.

“It is hereby ordered:

(1) That the application of interveners for a

restraining order be and the same is hereby denied upon the condition that the defendants shall enter into a stipulation with the plaintiff in the form annexed hereto marked exhibit A; and upon the further condition that said hearing upon said application of interveners shall be deemed a pre-trial hearing on the aforesaid issues as if properly noticed as such so that the court may make and enter an appropriate pre-trial order pursuant thereto; and

(2) That the aforesaid settlement with the United States government shall have force and effect in this action and as between the parties hereto solely to the extent that it reduces pro tanto the total amount in controversy herein and that in all other respects this court shall and does hereby preserve [13] the respective rights and positions of all parties and shall determine the issues and give judgment herein, in the same manner as if said tax saving had been allowed and said refund claim allowed and paid by the United States government in the ordinary course and manner prescribed by law and as proportionately reduced by said settlement.”

Now what is the effect of that pre-trial order? As I read it, it states that, for all purposes of this litigation, the position of this plaintiff shall be that of the possessor of the reduced refund claim proceeds just as if the United States government in the normal course had paid it to the plaintiff.

The Court: If you were entitled to it.

Mr. Levy: I am talking now of possession, your Honor; I am not talking about who ultimately may have title to it.

The Court: I don't see the relevancy of that. That was merely some order that was made so that if there were a result that would be favorable to the plaintiff, it would not be thwarted by the plaintiff being unable to realize upon it, so in order to put the parties in a position where if you did obtain a recovery you could not be defeated in that because of the fact that you lacked some possessory or other right in the matter, you entered into this stipulation.

Mr. Levy: Exactly. [14]

The Court: That presupposes. If it is determined that you are not entitled to it, what difference does that stipulation make?

Mr. Levy: Your Honor, as I read your opinion, has decided not that we are not entitled to it, not that the defendant is not entitled to it, but rather that the United States government is entitled to it, and as between these two litigants you are going to leave them where you find them.

The Court: That is not true. I think I also placed the decision on the ground that I couldn't see any reason why the plaintiff would be entitled to it anyhow.

Mr. Levy: That brings us to another point at which we quarrel.

Let us assume for the moment that your Honor did decide that you are going to leave the parties where you find them because this transaction was

so contaminated in origin that, as far as you were concerned, equity would not aid either party, or, as you put it, you would not commit further inequity by distributing it among these parties when in fact it belongs to the United States.

Now, as clearly as language could say it, in my humble judgment, the court said just that in its opinion. And just as clearly, it seems to me, that when a court of equity states that for grave and sufficient reasons the litigation, or the origin of the pot in controversy, it is so contaminated that [15] equity won't touch it but it will leave the parties where it finds them, that is a conclusive determination of the case, and it excludes as completely irrelevant any other considerations about who would in fact be entitled to this pot if the court felt that it could go and look at the equities as between the two parties.

Your Honor will probably recall from away back in law school days in the famous Hornbook cases of the old highwayman when thieves would fall out as to the devision of the loot and one thief would have the temerity to come to a court of equity and sue his partner in crime for a division of the swag other than that which had already occurred, and the court of equity said, "A plague on both your houses. A court of equity will not lend itself to the distribution of what originates in crime."

Now I know that isn't quite this case, but the conclusion in this case is an extension of it, and that is exactly what you held here. And I say that, having held that, then it becomes important to de-

termine where did you find the parties. And in determining where you found the parties no reference was made to this pre-trial order, and it is this pre-trial order which tells us where the parties were found on the day they walked into this court house to try this litigation. And if it doesn't do that, then it is hardly worth the paper it is written on. [16]

The Court: Well, I again have to say to you all that depends upon whether you are entitled to get it, and that is all, and I held adversely to you on that. I don't see how you can be helped by the pre-trial order, Mr. Levy. I have listened to what you have had to say about two years ago, but the ultimate result was that the court held that you were not entitled to it. If you are not entitled to it, then the fact that there was a pre-trial order that held that which you were quarreling about in a certain form does not help any, because that was not intended to be a determination of whether you were entitled to get it at all. I don't see how it can be converted into that as a result of any of the reasoning on which the court's decision was based.

Mr. Levy: Let me try to test that with the hypothetical. Let us assume that this plaintiff did indeed get the proceedings of the refund claim from the United States government. And your Honor's observations about how utterly preposterous any such thing would be would be just an appropriate had we received the refund claim as the settlement. Now the plaintiff has the proceeds of the refund

claim and the plaintiff is perfectly content to keep them as its share of the tax savings. Let us hypothesize that.

The Court: Even if the defendants agreed that you were to have them, it would not be up to the court to interfere with that agreement? [17]

Mr. Levy: That is just the point.

The Court: That is a different situation.

Mr. Levy: What happened next in my hypothetical is that the defendants did not recognize that plaintiff is entitled to keep them.

The Court: Then the plaintiff is only a stakeholder and he doesn't get any greater rights because he is made a stakeholder.

Mr. Levy: I am afraid, your Honor, you are not giving me an opportunity to pose my hypothetical.

The Court: Go ahead.

Mr. Levy: I want to come to grips with what I think is the fundamental issue.

Plaintiff says, "I am willing to keep that money; it is mine. I don't care; you can keep what you have." But the railroad company says, "Why, I should say not; you are not entitled to the proceeds of the refund claim." And then instead of what is now the plaintiff corporation suing the railroad company, the railroad company comes into this very court and sues the plaintiff corporation to get back the proceeds of that refund claim. That could just possibly have been the way in which this lawsuit was posed to your Honor. Indeed, so far as the pleadings were concerned, the counterclaim of the

defendant was just that: they wanted to get back the proceeds of the refund claim. Having come in before the court with Mr. Adams representing the plaintiff railroad company in its suit to get back the proceeds of the refund claim, the same debate occurs and the same trial is gone through, and the same evidence is presented to the court and the court writes the same opinion, only this time what the court says is this: "The whole payment by the United States government is eliminated for reasons A, B, C, D, E and F. I therefore will not commit the further inequity of distributing to this railroad company what this corporation has; it really belongs to the United States government; I am going to leave the parties where I find them." Where would you leave the parties then? You would have left this railroad company with \$10,000,000 and you would have left this corporation with \$4,000,000, and that would have been your decision.

Now, to my mind, that is exactly what you have before you in this case; no difference. The mere fact that the corporation is the plaintiff asking to get back from the defendant what the defendant has, and the defendant is counter claiming to get back from the plaintiff what the plaintiff has does not disturb the essential clarity of the hypothetical that I gave you. In each case the parties are coming to the court saying, "Give us a judgment that we are entitled to—a distribution." In each case the court is just as appropriately saying, based on your Honor's reasoning, that you must leave the parties

where you find them. So that it becomes crucial to find out where the parties were left, where you found them. That is the importance of the pre-trial order, because when I argued to this court on our injunction motion that the way to cut this Gordian knot is to place this money, physically transfer X dollars and to put them in the clerk's custody, your Honor's response to that was, by your pre-trial order, "You will have all of the incidents that attach and you will indeed be in the same position as having in your pocket or in the clerk's pocket the reduced proceeds of that refund claim."

Now if that is what the order says—and I submit that language could hardly be chosen which would say it more clearly—then your Honor, by concluding that the parties must be left where you find them, should give effect to the pre-trial order and say that you find this plaintiff in possession of X dollars.

Now let me come to the next problem. Let us take the highwayman case, just to make more graphic what we really have involved here. Supposing the highwayman's case when one thief sues another for distribution of the proceeds, the plaintiff thief comes into court and says, "Here is the contract that I have with my co-thief in which for good consideration complying with all the perquisites of the law of contracts, he has promised to give me 50 per cent of whatever swag we steal." There isn't any doubt in your Honor's mind [20] that you have a good contract there, you are entitled to recover. But the court says, "Oh, hold on; I am not

concerned with whether your contract is good, bad or indifferent. You are in no better position in this court than if you did not have a contract and you came into this court of equity asking for a fair distribution of the swag, because, as far as I am concerned I stop my inquiry short of analysis of the equities between the parties or their legal rights or equitable rights and I stop it short because this court of equity will not assist either of you in achieving relief against the other. I will leave you where I find you, and if you are unfortunate enough to be left with nothing and he is left with all, even though you have got a good contract otherwise, that is too bad; you don't get a decision; I am going to leave you where I find you." But alternatively you do have a situation there which is mutually exclusive, your Honor. A court of equity that goes to leave the parties where it finds them would be extremely careful that it would not in the same breath turn around and give judgment to the defendants to recover any part of the same swag of the plaintiff. The court is going to truly leave the parties where it finds them.

And that, I say, is the situation we have here. We have only, to my mind, one issue on this motion; that is, does the pre-trial order leave this plaintiff in the same position as if it had physical custody, possession, the right to [21] possession of the proceeds of the refund claim as reduced. It is utterly immaterial what the court would do were it disposed or empowered or authorized to look into the relative equities as between the parties.

The Court: But the refund claim, though, was abandoned.

Mr. Levy: Exactly. The refund claim was abandoned under [21A] the form of settlement as submitted, and we said that was prejudicial; that the settlement should have been so formed, or if that were not possible, that, by agreement of the parties, plaintiff should be given possession of the pro tanto reduction of the refund claim.

To put it more concretely, what you really had at issue was twenty-one million worth of taxes from the government. The settlement took the form of approving the two tax returns that were filed adding up to \$17,000,000 savings and rejecting the refund claim for the \$4,000,000. So, in fact, you had the settlement of \$21,000,000 savings by the payment of \$4,000,000 worth of taxes. Now the form that it took was that the claim for refund was waived.

The Court: Wasn't that exactly what you have done in the form in which it was handled? The net picture was that the defendant was liable to pay \$21,000,000 in taxes and it was satisfied to escape the payment of \$17,000,000. That was the net result.

Mr. Levy: Exactly. The purpose of our injunction——

The Court: The claim for refund may have been something else; it could have been some other item that was taken into account in determining the amount of the tax liability or non-tax liability of

the defendant. It was merely material that was there that was availed of and made use of in determining the extent to which the defendant did not pay these taxes. [22]

Mr. Levy: Exactly. That would be true if there weren't this litigation and if there weren't claims and cross-claims between this plaintiff and defendant.

The Court: I don't think the United States government paid any attention to that—at least I hope not—when it made the settlement of this matter.

Mr. Levy: None whatsoever, but we paid attention to it, since we were representing the plaintiff here, and our point was that since in normal course any refund coming would be paid to the plaintiff, and plaintiff would have possession of it subject to your Honor's determination; and in that normal course if the tax returns for '43 and '44 were approved they would have possession of those savings subject to your Honor's judgment. Our argument was in view of the pleadings and the defenses and the possible arguments, the settlement should not alter the position, the status quo of the parties. That was the argument we made. We were not asking your Honor to prejudge the case and we argued that we were entitled to keep the refund.

The Court: Suppose, Mr. Levy, there wasn't any tax paid, there was no refund made, the total amount of taxes due the United States was twenty-one million and it was settled by the taxpayer pay-

ing four million and not having to pay \$17,000,000. Would that have been any different than what was done? [23]

Mr. Levy: It would as far as the rights of these parties are concerned on the basis upon which the court has decided it.

The Court: Wouldn't the tax liability and tax savings have been the same?

Mr. Levy: So far as the United States government is concerned, it is just the same. Let me again revert back to the hypothesis of the highwayman. Suppose the man from whom they stole the money, all he knows was that his money was stolen, but as between one thief suing the other thief——

The Court: I don't think you should emphasize that——

Mr. Levy: I am making the argument because that is the origin of the whole doctrine. I don't think any of us needs to have a guilty conscience. I make the hypothetical because it emphasizes the nature of the problem. That is the way this problem comes into court for judicial determination more often than not.

To get back to the hypothetical, as far as the person from whom the swag came, of course it is immaterial what the pot is, it has all been taken away from him, and wrongfully, too. But when one of the co-venturers in this illegal venture sues the other co-venturer and the court decides, "I am going to leave the parties where I find them," then

it becomes important indeed to see who is sitting with what.

I am not appealing to the court to resolve who is entitled to what, and it indeed does not resolve who is entitled to what. It says, "I don't care who is entitled to what; I will not let a court of equity be used to further the rights of either party; I will leave them where I find them."

And to our mind the pre-trial order is what leaves us where this court should find us as of the date of this trial and as of the date of the decision.

The Court: That is the basis of your motion for reargument to amend the findings of fact?

Mr. Levy: That is indeed, your Honor.

The Court: There is another motion, is there?

Mr. Lasky: There is another motion which I would like to urge later because it has nothing to do with this subject matter. The plaintiff has submitted some proposed findings of fact. Finding No. 1 adopts the court's opinion and it is supplemented by six or seven specific findings and to make them specific, and raises the same issue which counsel has just discussed. I would like to supplement that since it is the subject matter you have been hearing about.

The claim for refund, if the court please, was not abandoned. What happened under the settlement was that the government rejected it. If a refund had been paid, it would have come to the plaintiff subject to your further orders as a court of equity as to what should happen to it.

Plaintiff declined to permit the defendants' counsel to consent to the rejection unless a stipulation was entered into. That stipulation which was filed in this court states in so [25] many terms that it must be deemed that the refund so allowed was paid to plaintiff as the agent for the affiliated group, and by the plaintiff paid into court.

After that stipulation was worked out which provides that it must be deemed a refund which had been paid to my client, Mr. Levy came in and objected that even that might not be clear enough, and on the basis of it he obtained your Honor's pre-trial order which provides in so many words that the case shall be decided "as if said refund claim had been allowed and paid by the United States Government in the ordinary course and manner prescribed by law."

That meant to the plaintiff, and in our proposed finding No. 7 we request the court to make a finding as to that, that that stipulation was entered into, adopting it by reference, and that the court order, the pre-trial order, should be entered.

Now whether or not the court believes that from those facts follow the conclusion for which Mr. Levy has argued, and in which we concur with Mr. Levy, I think it is pertinent to your Honor's theory and the facts should be succinctly found in the findings so that they can be presented to the Appellate Court.

I think Mr. Levy is correct when he is apprehensive, for this reason: Your Honor's basic reason-

ing—you may not have put it in your opinion, but at least the basic theory was that [26] here were parties taking part in something that was improper, the money did not belong to either, therefore a court of equity would not intervene.

Hence, if the \$3,400,000 must be treated for the purpose of this case as if it had been paid to the plaintiff, then, under your Honor's theory, it seems to me that the court would have to leave it also where it found it. Our proposed conclusion upon this amendment reads as follows:

“By virtue of the stipulation filed herein on September 5, 1947, and this court's order of August 29, 1947, the sum of \$3,385,000 must be deemed to have been refunded to plaintiff by the Treasury Department in the ordinary course and manner prescribed by law and by the plaintiff paid into this court.”

I may interrupt to say that that seems to follow inevitably from the stipulation and court order.

“Said sum is now held by defendant as agent of the court. Defendant should be directed to return said sum of \$3,385,000 to the clerk of this court, and the clerk should be directed to deliver said sum forthwith to the plaintiff in accordance with this court's opinion that the funds or tax savings resulting from the settlement with the government should be left with the party receiving the same; [27] and the court further concludes that defendant should not be required to account to plaintiff for any tax savings not represented by refunds.”

If the court please, it seems to me, and I respectfully submit, that that must be the conclusion that follows from the reasoning of the court's opinion, analyzing and following it through. If the money had actually been paid to the plaintiff, as it must be deemed that the refund was, would your Honor, under your opinion, now order the plaintiff, under the defendants' counter claim, to turn that \$3,300,-000 over to the defendant because in equity the defendant was entitled to receive it? Of course your Honor could, if that is the basis of your determination, make such a judgment, but on the basis of your opinion that you would not intervene, it seems to me that that cannot be the basis of the judgment.

The Court: I think I might say there that the basis of the court's saying that it would not intervene was a little bit broader and was based upon broader grounds than the mere technical situation, I suppose, that might have been created by the pre-trial order in the case. It is that, under the circumstances under which this whole tax situation developed and the results of it, as against that background the broad view that the court took was that the parties would be left where they were.

I don't think that the argument that you make in that [28] regard has changed the situation, because what you were trying to accomplish by this pre-trial order, as I recall it, and as I understand from statements that have been made, was to protect the plaintiff against any argument that might be

later made that the plaintiff did not have the right of possession of this. In other words, I did not make the decision as to leaving the parties where they were rest upon the mere possessory rights to this money or these tax returns as they may have been created by the parties, but against the background of the actual situation created by the so-called tax savings refund by the government. Perhaps I am not expressing myself clearly.

Mr. Lasky: I understand what the court is saying. I want to make two suggestions in response to it.

No. 1. The settlement with the government was not entered into with the formality required to be binding upon either side, which would have required approval of the Secretary of the Treasury. It became binding only because the government neither levied a deficiency assessment, nor did the plaintiff, in whose name suit for a refund would have to be filed, file another suit.

The statute of limitations on a suit brought by my client against the government did not run out until ten days before this court's opinion in this case. If the court had declined to approve that pre-trial stipulation under the pre-trial order [29] and had the court entered its opinion earlier than it did, the plaintiff could still have filed a suit against the government, and if it had prevailed on the tax claims the refund of \$3,300,000 would come to the plaintiff, not to the defendant; it would take the affirmative decision of this court or a court to make the plaintiff turn it over to the defendant.

However, if your Honor feels that the theory upon which you entered your opinion does not lead to the conclusion for which we contend, still there are the facts which we seek to have you find on, namely that the pre-trial stipulation was entered into and that your Honor entered your order on the basis of it. Those are facts which are material to the theory we propose to present to the Appellate Court.

The Court: I think you could have written this up, Mr. Lasky, without my making any finding in connection with it. As a matter of fact, I don't see how I could do that, because I am taking into consideration the pre-trial order in rendering the decision in the case. If you contend that that pre-trial order would have that effect, I think you should bring that up as part of the record, but I don't see what good it would do for me to make a finding that there was a pre-trial order made which I did not take into account. What advantage would that be to you?

Mr. Lasky: It will be a convenient and handy way to [30] present it to the Appellate Court. May I say that the plaintiff's finances are so restricted that it has got to think of the most convenient way of getting the record before the Appellate Court.

The Court: Well, the pre-trial order isn't very long. Can't you include that in your record?

Mr. Lasky: I suppose we could.

The Court: If you need any order from me to include it in the record, I will make the order.